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PRACTICAL REHABILITATION:
A GUIDE FOR THE REVITALIZATION OF OLDER, URBAN NEIGHBORHOODS

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A THESIS


in

The Graduate Program in Historic Preservation

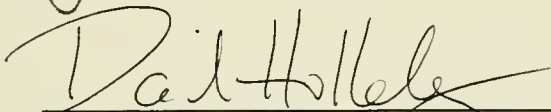
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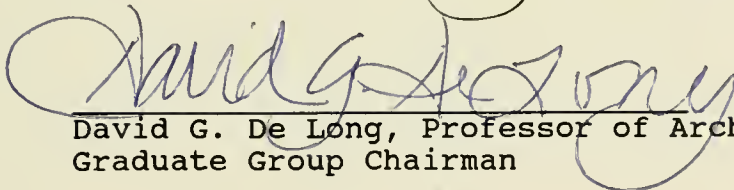
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CHAPTER 1

INTRODUCTION

Overview of Study

The United States is undergoing a reevaluation of priorities on the national agenda. A wide range of domestic concerns have gained considerable prominence. Family, education, the environment, social responsibility, drug awareness, cultural heritage, and housing are indicative of current priorities. Renewed attention can be attributed to many factors. Domestic and social institutions have been neglected in large segments of American society. The need to conserve and reuse natural resources has become apparent. These situations suggest a need for forthright policies to simultaneously benefit multiple concerns.

It has long been the federal government's policy to provide a variety of services for citizens who need assistance. Many Americans have a critical need for affordable housing. Despite long-term economic growth,

millions of lower-income citizens suffer serious housing-related deficiencies. Providing quality, affordable housing for a low-income population is enormously complex and difficult. There are many obstacles with few economic rewards. Yet, in our wealthy, industrialized nation, its absence is appalling. One cannot overestimate the positive social value that improved housing could bring. Better quality of life and a stronger sense of community could mitigate related social ills stemming from this fundamental deficiency.

Ironically, many low income neighborhoods already have an enormous stock of quality housing. It is found in the heart of many inner cities. Time, neglect, and lack of resources have taken their collective toll on the physical and social fabric of these communities. Therefore, the subject area for this study will be older, inner city neighborhoods, suffering from aging housing stock, limited economic investment, and sporadic social breakdown.

This study suggests that a well-conceived housing policy could benefit virtually all national priority issues. The fundamental feature of that policy should be the reuse of inner city neighborhoods to the maximum extent possible. The strategy for reuse should be practical rehabilitation, utilizing the resources and expertise of the public and private sectors. The purpose of this paper is to present a rationale and a practical guide for rehabilitation.

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This study suggests that rehabilitation be initiated privately and locally, with strong governmental financing and oversight. Expansion of the federal government's role in these areas must occur. This study identifies the most pressing housing problems as poor conditions, excessive cost burdens, and declining affordable inventory. Rehabilitation over new construction is the preferred approach to rectifying these conditions.

Historic preservation principles directly apply to this process. Traditional preservation is often perceived as relating primarily to historically significant resources. However, the concepts should be applied to many levels of the built environment. Though a different rationale exists, this study suggests that mundane, vernacular neighborhoods are as worthy of protection as nationally important buildings. Revitalizing viable buildings, regardless of their level of significance, is a fundamental tenet of preservation. Fortunately, current housing policy favors conservation of existing resources. J

An objective of this study is to demonstrate that concerned citizens can accept responsibility to rehabilitate housing, provided that governmental incentives exist. It will guide inexperienced practitioners through the rehabilitation process. This paper suggests that housing can benefit the broader objectives of community revitalization. It will also demonstrate how recent housing policy has led to the current

crisis in affordable housing. It will then argue that historic preservation principles should be applied to achieve successful results.

With the rationale and benefits of rehabilitation established, the study will demonstrate how partnerships are an effective means of achieving these goals. It will provide an overview of financial resources, including grants, loans, and tax credits, with evaluation of more viable sources. It will also mention the availability of certain regulatory programs that can benefit affordable housing efforts. Finally, the applicability of an inclusionary zoning ordinance will be presented. First, the importance of housing to community revitalization will be addressed.

Housing as a Central Component of a Community Revitalization Plan

Many factors contribute to the overall characteristics of a neighborhood. The residents, the pattern of land use, and the built environment are certainly major contributors. These forces act upon each other to create a community's character. While all communities are unique to themselves, they can be categorized into general types. This study examines inner city communities with large inventories of older, deteriorating housing stock. They grew around thriving industrial pockets. They commonly encircle the central, urban core, with its business, commercial, and residential zones. The surrounding inner city suffers from severe economic disinvestment, little opportunity for advancement, and patterns of anti-social behavior.

Solving these problems would be simpler if the root causes were accurately understood. However, the causes are numerous and interrelated. To put ailing neighborhoods on track, these deficiencies must be identified as best as possible. The most serious deficiencies should be rectified first. Only then will related symptoms of distress subside.

The focus of this paper is not to explain the failure of inner cities, or determine which problems are worst. It will address one acknowledged shortcoming which is central to urban distress. The built environment, especially housing, is considered a fundamental problem in poor, urban communities.

Substandard conditions, excessive costs of housing, and lack of resources for improvement have transformed housing from a stronghold of community stability to a shameful disgrace.

Older inner cities desperately require broad-based community revitalization. It can be defined as sustained viability, with economic development, quality housing, better infrastructure, stable social institutions, and a renewed sense of community. Housing is certainly among the most important components. It is difficult to predict the improvement specifically attributed to better housing. If unaccompanied by broader revitalization measures, the improvements would be short-lived. Assuming however that revitalization included economic and social development as well as housing, conditions should improve. Expecting housing to be a cure-all for deep-rooted social ills is unrealistic. With the understanding that housing is necessary but not sufficient, this study will examine that one component only.

A recent history of housing policy provides a rationale for broad-based revitalization. Experience of the last 60 years provides unfortunate examples of housing policies without community revitalization. Policy objectives were rarely realized. Social conditions often worsened as a result. The next chapter will review housing policies since the 1930s.

CHAPTER 2

CURRENT HOUSING SITUATION OVERVIEW

Recent History of Housing Policy

Federal housing policy has evolved considerably over the last 60 years. As situations and housing needs changed, policies and funding changed along with it. However, policies in general failed to achieve sustained economic and social improvement. This study suggests that their failure was a result of housing policy which failed to include community revitalization. This brief overview of national housing policies will begin with the Depression era, and demonstrate the lack of broader community revitalization efforts.

The U.S. Housing Act of 1937 authorized the provision of housing for those who could not afford it.¹ The government's objective was to alleviate the devastating effects of the Depression. Public housing was intended to assist low-income renters on a temporary basis, with the

Federal Housing Administration paying the costs. It primarily involved new construction, with limited rehabilitation.² HUD generally intended that local housing agencies would own the units. Philadelphia, for example, responded by forming the Philadelphia Housing Authority (PHA) in 1937. PHA owned and managed housing developments and scattered sites.³ The early federal and local housing policies assumed that renters would eventually regain their financial independence and find market rate housing. However, that objective was never realized. Public housing soon became permanent residence instead of temporary accommodation.⁴

In the post-war era, a tremendous housing need emerged. Enormous population growth and returning veterans established needs for housing, much of which occurred in the suburbs. As the middle class slowly emigrated from the city, poorer segments replaced them. Inner cities experienced economic disinvestment. Deteriorating housing conditions were addressed in the Housing Act of 1949.⁵ Its mandate was to provide "a decent home and a suitable living environment" for all Americans.

Urban renewal was at the core of the Act's housing policy for deteriorating inner cities. Urban renewal was intended to alleviate the social ills stemming from poor housing. Shortages and substandard conditions were both addressed.⁶ The Housing Act sought to replace decaying

houses with new, subsidized housing. By removing the most blighted areas, it intended to eliminate the source of social breakdown.⁷ Existing housing was often replaced with high-rise buildings and garden-style apartments.

The commitment to declining, urban neighborhoods under the 1949 Act was commendable. However, the plan had three serious shortcomings. The most fundamental deficiency was failing to include broad revitalization. Dilapidated buildings were removed, but the social conditions which caused them to exist were not changed. The second shortcoming was emphasizing only the most blighted blocks. Demolishing the worst sections led to deterioration in nearby stable areas.⁸ Consequently, those communities suffered in the process. Local residents were not sufficiently involved in planning.

The third shortcoming relates to the replacement building types, which proved to be even more detrimental. In Philadelphia, for example, housing stock consists mostly of street-facing row homes with private entrances. During the urban renewal period, they were replaced with new model forms, unproven in an American low-income application. High rise apartments, and internal-facing, garden court structures, both with public entrances, brought on numerous social and safety problems, which should have been predicted. Public interior space posed serious safety threats. Ironically, the traditional row home configuration addressed

these concerns.

Urban renewal's emphasis on housing assumed that housing was responsible for declining social structure. While it was a primary factor, it was presumptuous to assume that substandard housing actually caused the situation. More likely, substandard housing only contributed to, or occurred as a result of a general decline to which neighborhoods were predisposed. To make significant and sustained improvements, revitalization policy must contain multiple strategies for multiple problems. Expecting low-income housing projects to improve neighborhoods has proven to be unrealistic. Economic investment, jobs, neighborhood cohesion, and a sense of community must accompany housing. Without this approach, improvements in the physical environment will be temporary at best.

Policy makers apparently realized a lack of progress in troubled neighborhoods. They acknowledged that housing alone was neither the cause or the solution. More progressive efforts would include emphasis on improving existing buildings, utilizing private investment, and broadening revitalization. New, federal grant programs reflected a broadening scope. In the mid-1950s, Philadelphia's Central Urban Renewal Area Study (CURA) paralleled a growing, national shift. It recommended greater emphasis on conservation and rehabilitation of existing housing and infrastructure.⁹ Perhaps new strategies were more

appropriate than previous efforts.

In the early 1960s, Philadelphia's move towards rehabilitation was growing, though it was still overshadowed by draconian, urban renewal measures. Government loan programs, earmarked for low-income, owner-occupied rehabilitation became available. Low-income rehabilitation continued in small scale led by the Philadelphia Housing Development Corporation (PHDC), and emerging not-for-profit organizations.¹⁰ Community development corporations (CDCs) began constructing units as early as the late 1950s.¹¹

New programs included a greater range of participants. State and local government, as well as private interests stepped up their efforts. This policy is demonstrated in the National Housing Act of 1974, which provided legal authority for a considerable portion of federal housing programs. It empowers HUD to underwrite mortgage insurance provided through private lenders. It authorized community and project-based grant programs for housing and economic development. These facilitate participation by municipal governments and private institutions.

The primary policy objective was to increase the total supply of affordable units because decent, low-cost housing was becoming increasingly scarce. It did so by promoting new construction, substantial rehabilitation and moderate rehabilitation. While this study suggests that rehabilitation is the best alternative, many situations do

call for new construction. New construction is especially appropriate for increasing inventories. Both contribute to achieving broader goals.

The 1974 Act enacted programs with new policy objectives. Rental assistance was designed to supplement a household's rental payment instead of actually building a low-cost unit for the household to occupy. Two programs were devised. The first, Section 8, led to limited rehabilitation activity. Housing vouchers, the second, and current program, does not add to the housing stock at all. Vouchers represent a shifting policy from increasing the inventory to simply subsidizing the occupant. The merits of this philosophy will be discussed later.

Federal funding for housing was severely diminished during the 1980s. As a result, private investment has become even more necessary. The National Housing Act mentioned above and the Investment Tax Credit (ITC), introduced in 1976, were both designed to attract private investment. Tax credits are a dollar for dollar reduction in tax liability for the amount of the credit. Current tax credit programs promoted investment in historic buildings and low-income housing rehabilitation.

In a 1982 report by the Congress of the United States, policy makers recognized that no single program could assist low-income renters and promote construction. Therefore, they utilized multiple programs to achieve these two objectives.

Differentiating low-income rental assistance from construction and rehabilitation was expected to target resources more efficiently and reduce federal costs, without reducing housing opportunities.¹² Rehabilitation of existing units utilized tax credits and block grant funds. Low-income renters were subsidized through vouchers. However, the portion of rent for which an individual was responsible to pay was raised from 25 percent to 30 percent of monthly income. A partial repayment of subsidies was required if an owner sold his unit at a profit. The number of future housing commitments was reduced. Finally, funding for programs under National Housing Act was reduced.¹³

This strategy increased housing burdens for poor people by reducing inventories and increasing prices. The construction and rehabilitation objective was not adequately met. No new federally funded public housing was built after 1982.¹⁴ Available funding sources, such as block grants, included nonresidential construction.¹⁵ Vouchers did not adequately subsidize rents for those who needed assistance.¹⁶ HUD programs suffered cutbacks in funding throughout the 1980s.¹⁷ Existing rental subsidy contracts are quickly approaching expiration dates.¹⁸ In 1986, tax credits to promote rehabilitation became less attractive than they were. The strategy's impact is plainly seen in reviewing the current housing situation.

In response to the impending crisis, new players,

especially in the private, not-for-profit area are filling in where the government has backed away. Smaller, localized partnerships, with broad based support, are forming. A sense of ownership and responsibility has taken root in the form of community development corporations throughout the United States. These positive trends will more than likely represent the future direction of community revitalization and housing rehabilitation. However, the federal government's leadership and financial resources are still necessary.

This study advocates a policy of diversified community revitalization. Revitalization should promote a variety of programs with an emphasis on housing. The main objective of housing policy should be to conserve and improve existing stock to the maximum extent possible. Rehabilitation should be the primary tool, while new construction may be appropriate in some situations. All revitalization should be initiated on the local level, with the availability of federal funds.

In summary, housing policy has more or less evolved to reflect current needs. Public housing was first built as temporary housing for a Depression ravaged country. Post-war urban renewal expanded objectives to include better infrastructure in modern residential buildings. However, social structure decayed even further with slum clearance and new construction. Commitment to improving existing

housing grew out of urban renewal. Rehabilitation and new construction were aggressively pursued. Recent policy favors rental assistance to subsidize poor renters and localization of rehabilitation.

Current Overview of Affordable Housing on a National Level

Decent, affordable housing in the United States is becoming increasingly difficult to find, especially for lower-income Americans. Many factors contribute to the unprecedented crisis. The number of poor people, gross rent burdens, and the cost of home ownership have all increased dramatically in the past twenty years. These patterns are aggravated by decreases in the supply of affordable housing and the lack of funding. The implications transcend housing issues, pointing to worsening conditions on all levels. To grasp the situation's dimensions, this section will highlight cost burdens, decreasing inventory, and deteriorating conditions. A brief explanation of income categories is necessary to better understand the situation.

The government divides households into five income categories. Very-low-income is defined as incomes between zero and 50 percent of the area median. Low-income means between 50 and 80 percent of area median. Moderate income is a household between 80 and 120 percent of area median.

Cost Burdens of Ownership and Rental

The cost of housing is a key determinant of one's standard of living. The U.S. Department of Housing and Urban Development (HUD) considers spending 30 percent of a household's income towards rent or mortgage to be affordable. For households earning \$10,000 annually, affordable rent translates to \$250 per month. Cost burdens are most severe for those with incomes under \$5,000 annually. The central issue relating to the cost of housing is the number of households exceeding the 30 percent standard.

Costs for home ownership have increased sharply. The after-tax cash cost serves as a basis of comparison for ongoing housing expenses. Studies show after-tax cash costs have steadily increased since 1967. This pattern is not expected to change.¹⁹

Home ownership has fallen for households earning less than \$10,000, especially in younger age groups. It simultaneously increased for households earning more than \$50,000.²⁰ Accumulating funds for down payment and early carrying costs has become increasingly difficult with high gross rent burdens. In 1985, 73 percent of all households exceeded the HUD standard for affordability. Some households spent 70 percent or more of their income on housing.²¹

The situation is more severe for renters. Gross rents are at the highest level in 20 years. Median rent is increasing faster than median income, resulting in larger gross rent burdens.²² Assistance commitments underserve the

eligible population. In 1982, 28 percent of poverty level renters received assistance or lived in public housing.²³ The 1987 figure was consistent at 29 percent.²⁴ Despite the economic recovery of the 1980s, low-income households have experienced a declining income pattern since the late 1960s. This resulted in a 26.3 percent long-term increase in poor households between 1974 and 1987. During that same period, the total number of households with annual incomes under \$5,000 increased by 55.1 percent, from 4.7 million to 7.2 million.²⁵ Statistics compiled in 1985 by HUD and the U.S. Bureau of the Census show that 85 percent of poor renters had monthly payments which exceeded the 30 percent standard. Sixty-seven percent spent at least 50 percent of their income on gross rent. Almost half of all renters spent at least 70 percent of their income on gross rent.²⁶ Wealthy individuals do not dedicate such high percentages of their incomes to rent or mortgage.²⁷

Renters fail to benefit from significant tax savings associated with home ownership. Mortgage interest deductions provided wealthier homeowners with approximately \$107 billion in tax savings in 1987 and 1988. That figure is within \$1 billion of the total spent for subsidized housing programs from 1980 to 1988.²⁸

Increasing the cost of construction and rehabilitation causes additional cost burdens. Overregulation was cited by numerous Presidential Commissions in the last 30 years, as

contributing to the excessively high cost of housing.²⁹ Substantial rehabilitation standards can increase construction costs more than the savings associated with tax credits. Retrofitting older buildings to current design and safety standards often surpass realistic needs for comfort and security. Holding costs associated with slow permit processing adds administrative expenses. Clearly, reasonable changes could reduce project costs without compromising quality or safety.

Decreasing Inventory

Two major factors contribute to the loss of affordable inventory. Existing units are removed from the low-income market. There are fewer new units being constructed and rehabilitated. Many factors result in the loss of units. Dilapidated units must be demolished or abandoned because of insufficient funds to repair them. Arson accounts for significant losses. Expiration of government contracts will result in the lifting of low-income occupancy requirements. Most current voucher contracts will expire by the end of 1994.³⁰ Market rate conversion is the likely result for many expiring contracts.

Since the mid 1970s, the inventory of low-income units dropped while market rate units increased, especially on the fringe of low-income neighborhoods. In 1974, there were 11.4 million units renting at or below \$300 per month. That number dropped to 10.45 million units by 1983. As mentioned

earlier, the low-income population increased significantly during that same period.³¹

The result is that more poor households are competing for fewer units and less federal funding. In 1970, it was estimated that affordable units exceeded demand by approximately 2.4 million units. In 1985, demand exceeded supply by approximately 3.7 million units, with 7.9 million units to serve 11.6 million eligible tenants.³² For households earning under \$5,000 annually, 2.1 million units were available for the 5.4 million households in 1985.³³

In addition to loss of existing units, fewer new units are being built. The federal government discontinued building public housing in 1983, in favor of greater dependence on private organizations.³⁴ Rental assistance, the current form of subsidy does not promote the construction of units. This program will be virtually ineffective as affordably priced units become scarce. Declining inventory is closely related to poor conditions.

Housing Conditions

Though substandard conditions are not considered a national concern, conditions in much of the affordable inventory are appalling. The main reason is a lack of funds for repairs or new construction. The American Housing Survey conducts comprehensive analyses on housing quality and conditions, with data reflecting various categories. Figures show that the percentage of deficient households has declined

since 1974. However, this figure is misleading. It reflects a growth in the total number of housing units rather than a reduction in the number of substandard units. In 1983 there were still five million renters and nearly as many homeowners with structurally inadequate dwelling units.³⁵ Nearly 80 percent of all units renting for under \$250 per month are over 20 years old.³⁶ The funds required to renovate 1.3 million HUD units far exceed actual budget proposals.³⁷

The general pattern is clear. Chronic deficiencies are occurring at an increasing rate. The situation is relatively worse than it was 20 years ago. Severe shortages of quality units, long-term increases in the eligible population, increasing cost burdens, and a shrinking federal commitment combine to form a crisis of scandalous proportions. Immediate action has never been so important. Since the impact of housing is central to a revitalization plan, its failure will undermine any coordinated improvement efforts.

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CHAPTER 3

THE ROLE OF HISTORIC PRESERVATION IN THE REHABILITATION OF HOUSING

Rehabilitation as the Best Alternative

Chapter two identified inner city housing problems as the result of declining social institutions instead of the cause. Policies to rectify bad housing should treat it as a symptom of more fundamental problems. Ideally, a policy of prevention would remove the conditions which caused bad housing to occur. However, current deficiencies must be fixed before future occurrences can be prevented. This paper argues that rehabilitating the existing environment and infrastructure is the best form of treatment. Current housing policy evidently favors rehabilitation, as it overtook new construction spending in 1983.¹

Perhaps more than most, the preservation community understands the value of saving existing, urban fabric. For reasons already expressed, structurally sound buildings ought to be saved. For older, urban, low-income neighborhoods,

buildings have more collective importance as part of a community than on their architectural merit. Therefore, a mechanism must be developed to protect the most valuable features without imposing excessive cost burdens. Existing mechanisms may, in some cases, impose certain design restrictions which, in turn, raise the costs of rehabilitation. While design restrictions are appropriate for buildings of significant architectural or historical importance, such restrictions are not necessary for inner city housing.

The first section of this chapter will define rehabilitation and the appropriate level of intervention. It will design a rehabilitation mechanism suitable for non-historic, low-income neighborhoods. The new mechanism will use the existing Secretary of the Interior's Standards for rehabilitation as a model, identifying a new level of intervention in the process. The second section will highlight economic and social benefits to rehabilitation. Finally, the chapter will address common problems associated with rehabilitation.

An Appropriate Definition of Rehabilitation

A clear definition of rehabilitation must be established to guide practitioners. On the most basic level, rehabilitation is a reactive treatment to an existing adverse condition in the built environment. Rehabilitation involves

varying degrees of intervention to make "ailing" buildings "healthy" again. Each level of intervention is appropriate for a particular building and situation. This study suggests that traditional mechanisms for intervening do not ideally suit low-income housing in older, urban neighborhoods.

By modifying the traditional definitions of intervention, using the Secretary of the Interior's Standards for rehabilitation as a model, a more appropriate guideline for low-income rehabilitation can be developed. The new guideline would maintain the spirit of the existing guidelines and protect the positive characteristics of low-income neighborhoods. Yet, it would allow reasonable compromise to accommodate economic and social limitations of low-income neighborhoods. These modified guidelines will be called practical rehabilitation.

Practical rehabilitation is defined as intervention that preserves the integrity of the form, scale, rhythm, context, and character of existing buildings. These are the elements that should be saved. Yet, it allows replacement or removal of certain elements whose absence would not detract from the building's general character.

Under practical rehabilitation, form is specifically defined as the basic configuration of existing buildings. If an existing configuration works better than other alternatives, it should be saved. In Philadelphia's case, the form is a two or three story row house, with a street-

facing entrance. The scale is low-rise, street-oriented, with single family occupancy. Rhythm refers to the relationship between individual elements in the neighborhood to each other and to the larger area. The rhythm in Philadelphia is rather obvious and repetitive. Blocks are predominantly row homes, with scattered, non-residential usage and open space areas. Changing the rhythm may be appropriate in order to fulfill other revitalization objectives, such as the need for more open space, institutional, or commercial activity. Context refers to the current use and the current occupants of the neighborhood. In Philadelphia, the context is lower-income, residential occupancy. A neighborhood's character is slightly more theoretical. It refers to qualities that essentially define the neighborhood. Broadly speaking, it combines all of the above elements to "characterize" a neighborhood. This study does not suggest that the Philadelphia row house is the only building type in which to apply practical rehabilitation. However, in this case, it is the existing building type which appears to work better than alternatives discussed earlier.

The qualities generally protected under practical rehabilitation are perceived on the neighborhood level. They are seen from the streetscape and effect the overall livability of buildings. Factors like a building's height, its orientation to the street, its type of entrance, the amount of open space surrounding it, and its usage are considered in practical rehabilitation.

Other characteristics of buildings have less direct influence on form, scale, rhythm, context, or character. They would not be considered under practical rehabilitation. For example, interior floor plans, exterior surface finishes, and architectural ornamentation would not be restricted, or even considered under practical rehabilitation. This does not suggest arbitrary, insensitive treatment of these characteristics. They should be saved to the limits of economic feasibility. In the extreme case, however, if gutting an interior and applying stucco to exterior surfaces was economically advantageous, the building would still conform to practical rehabilitation standards.

Specific rehabilitation standards can be codified using the Secretary of the Interior's Standards as a model. The Secretary of the Interior defines rehabilitation, as it relates to buildings listed or eligible for the National Register of Historic Places, as:

"The process of returning a property to a state of utility, through repair or alteration, which makes possible an efficient or contemporary use while preserving those portions and features of the property which are significant to its historic, architectural, and cultural values."²

The Secretary's Standards are used to define "substantial rehabilitation" to which projects for National Register buildings must conform in order to receive certain financial incentives. Since practical rehabilitation would not generally be applied to buildings listed on the National

Register, the substantial rehabilitation test does not apply. However, the Secretary's standards serve as an excellent model for the preservation of all buildings, regardless of their significance.

Though the Secretary's Standards make an excellent basis for a consistent, affordable, rehabilitation plan, certain modifications are necessary. These modifications are not suggested to "water down" the standards as they apply to substantial rehabilitation. Instead, they are suggested so an appropriate level of intervention can be consistently applied to non-historic buildings. Ideally, incentive programs could be tied to practical rehabilitation as they are tied to substantial rehabilitation. Specific modifications to the Secretary's Standards will be discussed next.

The fundamental change would be reducing the required degree of architectural integrity, and removing the requirement to preserve those features which are significant to a building's historic, architectural, and cultural value. Specifically, standards two, three, five, six, and ten would be modified. Standards one, four, seven, eight, and nine would not require modification.

Standard two states that distinguishing qualities and character of buildings shall not be destroyed. Altering of historic materials or features should be avoided.³ The new standard would allow removal or alteration of distinctive architectural features if repair would impose any increased

cost burdens. Features would be treated with an importance commensurate with their overall contribution to the neighborhood. If their condition is bad, and repair is too costly, they could be removed completely, without detracting from the neighborhood's quality.

Standard three discourages alterations that have no historical basis, or seek to create an earlier appearance.⁴ Practical rehabilitation would not discourage alterations or different interpretations of original fabric. Non-historic alterations would be permitted.

Standards five and six would be given similar consideration as standard two. Standard five requires the sensitive treatment of distinctive stylistic features or examples of skilled craftsmanship. Standard six requires repair for deteriorated features whenever possible. It also states that replacement should match original fabric in visual and compositional qualities.⁵ With practical rehabilitation, these two standards would be upheld to the point where economic constraints make it unfeasible. If affordable replacement technology exist, then naturally, it should be used. However, if such technology is unavailable, rehabilitation should proceed with the best affordable alternative, including loss of stylistic features.

Standard ten provides for the reversibility of additions and alterations.⁶ Under practical rehabilitation, a greater degree of permanence would be tolerated, especially for

alterations. For example, changing masonry openings to fit a standard window frame would be permitted.

The fundamental difference from the Secretary's Standards is accepting a lesser degree of integrity, and permitting reasonable losses of significant features. It would permit greater lenience with alterations that do not change a building's general character or form. Repairing architectural details and surface finishes, or altering interiors can impose significant cost burdens. Yet, unsympathetic treatment in this regard will have minimal adverse impact on the neighborhood's character, or on community revitalization objectives. Practical rehabilitation would permit reasonable losses of integrity in order to insure greater economic feasibility.

The resulting degree of intervention would be a combination of the traditional definitions. James Marston Fitch defines levels of intervention in his book, Historic Preservation: Curatorial Management of the Built World. He describes them from least to most radical. The first three are relevant to practical rehabilitation. Preservation is defined as maintenance of an artifact in the same physical condition as when received. Nothing is added or subtracted from the object. Measures to maintain the physical integrity should be minimal and unobtrusive.⁷ He defines restoration as returning an object to the physical condition of an earlier stage in its life, as determined by interpretation of its

history.⁸ Conservation/consolidation is defined as physical intervention in actual fabric of the building to ensure structural integrity. Building materials are physically stabilized to halt or reverse decay.⁹

The level of intervention for practical rehabilitation is a synthesis of all three. Low-income housing will essentially be preserved in its current form. However, materials must be added and subtracted to bring them to a state of utility. Therein lies the need for conservation. Materials must be physically stabilized and improved. Buildings should be restored to the extent that they are returned to a state of utility. However, their appearance need not conform to a specific point in history.

The Advantages of Practical Rehabilitation

The benefits to practical rehabilitation are best summarized under two main categories, economic and social impacts. The economics of rehabilitation versus new construction is often debated. The real costs depend largely on the level of intervention. Practical rehabilitation offers a less expensive alternative than substantial rehabilitation and a more desirable alternative than new construction. More expensive restoration may be appropriate for significant, national monuments. However, it is not necessary to achieve community revitalization objectives.

Numerous studies simply state that rehabilitation can be

less costly than new construction. The National Institute of Building Sciences even says that new construction on conventionally acquired land is the most expensive way to build housing. It further states that a policy favoring new construction over rehabilitation is impractical. A less expensive route is to "utilize the existing stock of poor quality units and abandoned units found in urban areas throughout the country."¹⁰ The Enterprise Foundation concurs, arguing that continued maintenance is less costly than replacement. It estimates that a typical low-income unit could be brought to a maintenance-only level for far less than new construction cost.¹¹ The Community Information Exchange cited the economic advantages and potential cost savings to better utilization of abundant, existing resources.¹² The National Trust for Historic Preservation states that non-historic rehabilitation, but not substantial rehabilitation, is less costly and more practical than new construction.¹³ Emerging consensus points to rehabilitation as the most practical alternative for fulfilling the multi-million unit need for decent affordable housing.

Social and cultural advantages to rehabilitation are well documented by the failure of urban renewal. One fundamental advantage is the proven viability of the existing housing form. The common Philadelphia model, a two or three story brick row home facing the street, has been in continuous urban use for hundreds of years, whereas forms applied in the urban

renewal era failed almost immediately. Acknowledging that a building's form has limited influence over its occupant's behavior, it still makes sense to use the more successful row house form. The National Institute of Building Science agrees, recognizing that well designed low-income housing would minimize the adverse impact on a neighborhood's viability.¹⁴

Historic and aesthetic considerations give added advantage to rehabilitation. Preservationists have long held that preserving the built environment gives continuity and understanding to cultural heritage. This is essential for a successful environment. Social and cultural history is clearly manifested in built forms. Connections with the past are essential to better understanding how the present evolved, and how to anticipate the future. A conscious awareness of connections with the past is not necessary to benefit from its teachings. Human scale, comfortable spaces, aesthetic decorations, and understandable forms historically made neighborhoods more livable and workable. Those benefits still exists today. A group effort to preserve existing buildings can even mobilize neighborhood interest and unite individuals.¹⁵

For all of these benefits, economic, societal, and historic, certain conditions must occur for rehabilitation to be the best alternative. Saving existing buildings is only better if their condition and their surroundings are

reasonably healthy. If structural deterioration is too great, rehabilitation may be too expensive. Therefore, the decision to rehabilitate must consider the best use of limited economic resources. If local surroundings are too blighted, even a healthy building would not improve its occupant's situation, and the building should not be saved. The decision not to save it is purely a preservation issue. When deciding what buildings to save, one must balance economic limitations with realistic expectations of what buildings will bring the most social benefit.

Limitations of Practical Rehabilitation

The greatest rehabilitation difficulty is economic in nature. Overregulation and expensive retrofitting directly effect a project's economic feasibility. Rehabilitation is more prone to inaccurate price estimates and cost overruns than new construction. However, marginal cost differences can be easily compensated with the long-term, economic and social advantages derived from better neighborhoods. Costs are often increased because historic rehabilitation is inappropriately applied. Inflexibility of building and zoning codes impose excessive costs on rehabilitation.¹⁶

Minor shortcomings with rehabilitation should not be seen as disincentive to this strategy. No revitalization plan is without criticism. These obstacles must be overcome wherever possible. It involves commitment from government on all

levels, private financiers, and local residents. It will also require guidance from the preservation community.

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CHAPTER 4

PUBLIC/PRIVATE PARTNERSHIPS AS AN APPROPRIATE MECHANISM FOR REHABILITATION

What Partnerships Do

Critical issues must be brought to the forefront of the national housing situation. Government and the private sector cannot turn their backs on affordable housing shortages. Government is driven by responsibility and its mandate. The private sector should respond for their own long-term interest and moral obligation. Yet both groups appear unwilling or in fact unable, to undertake the task alone. Only the federal government has adequate resources, but has diminished its participation. Therefore, this study suggests that private interests should initiate practical rehabilitation with the financial backing of public institutions. This section will present information on how that can be accomplished. It will also discuss the growing number of public and private institutions with increasing competence and involvement in housing. It will also suggest the need to promote

public/private partnerships through policy and legislation. The use of partnerships does not have corporate implications. Instead, it refers to formal associations between various entities from the public and private sector, for the expressed purpose of providing affordable housing.

A well structured partnership could be the most effective approach to rehabilitation. The three levels of government should have specialized roles. The federal government should provide the bulk of funding through grants, loans, subsidies, and tax incentives. Funding sources should be structured to encourage private initiatives and attract nominal matching funds. Large matching fund requirements might discourage private investment. State and local governments should be positioned to assess needs, structure programs and participate in projects.

The private sector should be responsible for undertaking actual rehabilitation projects. Developers, CDCs, and other private, local sponsors must receive proper incentives for their efforts. The underlying rationale for partnerships, therefore, is to utilize each player's most valuable attributes and reward them appropriately.

Local sponsorship is a major feature of current rehabilitation practices. The Community Information Exchange supports local control. Neighborhood groups, they say, have greater autonomy in initiating and maintaining community-controlled housing and economic development projects. Local

control better insures the benefits to local residents and minimizes displacement.¹

An important advantage to partnerships is the increased pool of resources, both financial and expertise. Programs that are designed as matching funds attract private investment to supplement federal appropriations. Partnerships spread the risk, broaden the scope of responsibility, combine talent and expertise, and increase commitment levels for success.

Implementing A Successful Model

Though the task of rehabilitating housing is truly complex and daunting, this section will attempt to demonstrate how a group of concerned citizens can organize an effective strategy for community revitalization. That strategy begins with a leadership core, building a broad based partnership, and working through the process.

The structuring of affordable housing rehabilitation projects is among the most complicated transactions in real estate development. Numerous funding sources, low profit margins, and high costs are chiefly responsible. However, its inherent complexity should not discourage neighborhoods from rehabilitation. A partnership could institute standard procedures to simplify the process. Such procedures include organizing a core group, utilizing project-based agreements, including diverse participants, maintaining a clear vision, and working through the myriad of funding sources. This

approach insures that each project is properly structured for the specific circumstances.

The most fundamental participant in the partnership is the central player or project leader, to oversee the process. Since governmental leadership, is minimal and private interests will not readily intercede, this study suggests that leadership responsibility must originate from within the community. One viable form for the leadership core is the Community Development Corporation (CDC). Incorporated as a private, not-for-profit, it gains favorable tax status and permits participation in federal housing programs.² Incorporation for not-for-profits requires only nominal fees and legal proceedings.³ The CDC should be a standing group serving as a basis for building project based coalitions.

An important task for the CDC is arranging financing. Pre-construction expenses include organizing, consulting, architectural, engineering, and legal fees, as well as reserves. This "seed money" can be obtained from a variety of sources. Often, pre-construction costs will come from non-governmental sources. The CDC must also secure construction financing. It comes from a combination of government and private sources including grants, subsidies, commercial loans, and, if applicable, tax credits. (An examination of sources of financing will follow.) Permitting and acquisition procedures come next. Architects, engineers, and contractors must be retained to design and construct the actual

rehabilitation project. Throughout the project, the CDC, or its representative, will oversee the process.⁴

Some cities have public housing offices or agencies that do the job of a CDC. In Philadelphia, the Office of Housing and Community Development (OHCD) is a non-charter agency, created by the Mayor in 1976.⁵ In 1988-89, OHCD was responsible for the rehabilitation of 1100 housing units, the largest annual number in its 15 year history.⁶ OHCD monitors all projects it subsidizes in monthly meetings of the Rental Rehabilitation Council.⁷ The Council fulfills an important oversight and policy making role by meeting with public and private agencies engaged in rehabilitation.

In the absence of an agency like OHCD, CDCs must have considerable understanding of real estate development, low-income housing legislation, and business management skills. Deficiencies in this knowledge can be easily addressed. Technical assistance and training organizations are available to assist CDCs. The Development Training Institute in Baltimore provides CDC managers with training in business, real estate development, finance, strategic planning, and management. Similar groups provide related services including fund raising, market analysis, contract negotiations and database information.⁸ Outside consultants and partners provide other services including needs assessment, project feasibility studies, cost estimations, and project financing.⁹ CDC training programs are generally supported by grants from

national corporations and foundations.

Thus, CDCs need not have expertise in all facets of development. It is more important that they possess the drive and vision to conceive and carry out the process. Outside assistance can compensate for lack of experience. Approximately 2000 CDCs nationwide attest to their effectiveness. They are generally expanding in range and scale of activities.¹⁰

Important Players in Public/Private Partnerships

Partnerships are formed on a project-based need, instead of existing as standing groups. Most have been formed since 1983, attesting to the newness of this strategy.¹¹ With an established core group, partners must be assembled. The group will consist of public and private organizations. Traditional separation of responsibility will be blurred. The private sector will build housing where only the public sector previously did so.

The following list of participants is compiled from actual programs in Boston, Chicago, Cleveland, New York City, the Massachusetts Housing Program, and Wisconsin.¹² Local, public players often include one or more of the following: the local Housing Office, Public Housing Authority, Office of Community Development, the Mayor's office, a zoning board, and frequently, a quasi-public, city chartered housing or community development corporation. State housing and

community development agencies are also represented in the process.¹³

The private sector provides significant resources. Connection with the banking community is essential for securing commercial debt. Equity financing comes from investment groups forming Limited Partnerships. Diverse members of the business and corporate community include home builders, human services representatives, attorneys, realtors, manufacturers, planners, and numerous community development foundations. Even civic groups and associations such as labor leaders, building inspectors, and unions provide expertise.¹⁴ Members of the clergy have taken an active role.

Choosing the appropriate participants is largely a function of specific project requirements. They should be chosen for specific qualifications. If for example, the rehabilitation project will convert a four story building zoned for single-family to multi-family apartments, the zoning board would be involved with the project. No formula exists to combine the appropriate players. Building project-based coalitions around a standing, neighborhood-based CDC, is the best way to meet the project's specific circumstances.¹⁵

Partnership Goals and Objectives

With a full group in place, the public/private partnership is ready to draw on its resources and expertise. It must plan the actual rehabilitation, assume management

responsibilities, provide seed money to attract further investment, structure syndication packages for equity investors, and seek construction grants and loans. Perhaps the most important component is a clear mission and goal statement.

The most basic goal must be to provide affordable housing for lower-income renters and owners. An objective is to utilize existing housing stock, especially units that would not displace existing tenants. Abandoned, tax delinquent, and vacant, publicly owned units meet these requirements. They can be acquired at minimal or no cost. Philadelphia's Gift Property program acquires tax delinquent properties at a sheriff's sale. They are then transferred to private individuals for settlement costs only. Tax delinquency must be for at least two years and greater than \$800.¹⁶ Another objective already discussed is to establish a broad range of partners. A more diverse group will be able to achieve diverse objectives.

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CHAPTER 5

OVERVIEW OF SELECTED GRANT-IN-AID, SUBSIDY, AND LOAN PROGRAMS

The U.S. Department of Housing and Urban Development

The bulk of rehabilitation and housing assistance funding comes from the U.S. Department of Housing and Urban Development (HUD). Though a wide variety of HUD programs exist, some are currently inactive or receiving minimal funding. Tax credit incentives have initiated private investment to replace HUD's direct subsidies. HUD's strong participation is still critical to a successful housing initiative. Without dedication of funds, essential government participation will not occur. Yet HUD's budget has been continuously reduced in the 1980s. The 1980 budget of \$35.7 billion was cut by more than half to \$14.2 billion by the year 1987.¹ The 1988 budget was only \$9.8 billion.² HUD discontinued building public housing in 1983. As of 1987, the inventory was 1.34 million HUD-owned units, with additional subsidies for 4.2 million households.³

Numerous HUD programs are designed to encourage rehabilitation activity through mortgage insurance. Among its functions, mortgage insurance is designed to protect lenders from the risk of default on loans made to low- and moderate-income households. Federal mortgage insurance minimizes the high risk of rehabilitation for developers, builders, and owners.

The more viable programs today award large blocks of money with fewer use restrictions, characteristic of the federal government's reduced involvement. Another changing aspect of housing is the shifting emphasis on rental assistance instead of building affordable units. The earlier programs will be examined first.

Brief Overview of Programs

The programs discussed all promote rehabilitation though many also apply to new construction and purchase money. These programs allow homeowners and renters a chance to acquire decent housing where unaided market conditions are unfavorable. While many programs are directed at households at or below 80 percent of the area median income, each program is targeted towards groups with specific needs. In addition to income requirements, programs have varying maximum coverage limits.

The following list briefly outlines the function of current HUD housing assistance programs. Programs are listed

by section number of the National Housing Act, or other authorizing law. They are administered by the Federal Housing Administration (FHA), which is part of HUD. The first group of programs promote home ownership.

**Mortgage Insurance for One- to Four-Family Homes.
Section 203(b) and 203(i)**

- Designed to promote home ownership.

- HUD insures up to 97 percent of urban or rural home loans. When homeowners faces foreclosure for reasons beyond their control, such as loss of job, death, or illness, they may apply to assign their mortgage to HUD.

If accepted, HUD would adjust payments accordingly.⁴

Mortgage Insurance and Interest Subsidy for Low- and Moderate-Income Families. Section 235

- Mortgage insurance and interest subsidies for low- and moderate-income home buyers.

- Applications have not been approved since 1983, except in certain areas subject to a statutory exemption. This program is inactive.⁵

- No new funds provided since 1981.⁶

**Mortgage Insurance for Low- and Moderate-Income Families.
Section 221(d)(2)**

- Mortgage insurance for low- and moderate-income housing households

- One- to four-family units.

- Special consideration given to those displaced by urban renewal.

-Mortgages insured up to \$31,000 for single-family home, adjusted for family size, multi-unit housing, and regional cost of living differences.⁷

Mortgage Insurance for Housing in Declining Urban Neighborhood.

Section 223(e)

-Insures the purchase or rehabilitation of housing in older neighborhoods experiencing decline.

-Insures lenders investing in declining but viable neighborhoods.⁸

**Mortgage Insurance and Counseling for Special Credit Risks.
Section 237**

-Insures low- and moderate-income housing families with negative credit histories.

-Insures lenders on losses for marginal credit homebuyers.

-Debt counseling provided by HUD-approved organizations.⁹

**Mortgage Insurance for Condominium Housing
Section 234**

-Insurance to finance ownership of individual units in multifamily housing projects.

-Insures mortgages to finance units intended to be sold as condominium units.¹⁰

**Mortgage Insurance for Cooperative Housing.
Section 213**

-Insures cooperative housing projects of five or more units, occupied by members of not-for-profit cooperative

housing corporations.

-Owners can occupy or sell units to a not-for-profit cooperative.¹¹

Rehabilitation Loans
Section 312

-Insures reduced interest loans to homeowners and landlords to finance rehabilitation of properties requiring significant repairs to meet code standards.

-Authorized through local agencies for low-income individuals.¹²

Rehabilitation Mortgage Insurance
Section 203(k)

-HUD insures rehabilitation and outstanding indebtedness for existing properties, also finances purchase of property.

-Cumulative totals from 1978 through 1987, 5,109 loans with value of \$91.8 million.¹³

Insurance for Home Improvement Loans.

-HUD insures individual, home equity loans for major and minor improvements, alterations, and repairs.

-Insures up to maximum of \$17,500, or \$8,750 per apartment unit, not to exceed five units. Maximum term, 15 years.¹⁴

The following programs benefit renters:

Rental Rehabilitation Grants and Rehabilitation Loans.
Section 312

- Rent subsidies for lower-income tenants whose buildings are being rehabilitated, or assists to relocate to other suitable housing.

- Loans and grants to cities and states.

- Total of \$150 million allocated in 1989.¹⁵

**Mortgage Insurance for Multifamily Rental Housing.
Section 207**

- Construction or rehabilitation of a broad range of rental housing.

- Insures mortgage loans by lenders financing multifamily rental housing of five or more units, built by private or public developers.

- Must accommodate reasonable rents.¹⁶

**Mortgage Insurance for Existing Multifamily Rental Housing.
Section 223(f)**

- Insures existing multifamily rental units originally financed with or without federal mortgage insurance.

- Does not require substantial rehabilitation.¹⁷

- Cumulative totals through September, 1985 are 489 projects, (109,239 units) with mortgages totalling \$1.68 billion.¹⁸

Mortgage Insurance for Multifamily Rental Housing for Low- and Moderate-Income Families. Section 221(d)(3) and 221(d)(4)

- Insures mortgage loans made by private lenders to finance construction or substantial rehabilitation of low- and moderate-income housing, with five or more units.

- Units can be rental or cooperative.
- 221(d)(3) insures 100 percent of total project costs, if mortgagor is a not-for-profit or cooperative.
- 221(d)(4) insures 90 percent of total project costs, regardless of mortgagor status.¹⁹
- Cumulative totals through September 1984 for 221(d)(3) were 2002 projects (170,630 units) with mortgages totalling \$3.06 billion. Cumulative totals through September 1984 for 221(d)(4) were 6960 projects (763,503 units) totalling \$20.7 billion.²⁰

**Mortgage Insurance for Housing for the Elderly.
Section 231**

- Finances rental housing for the elderly or handicapped.
- Insures mortgages made by lenders to finance building or rehabilitation projects of eight units or more.²¹

Housing Development Grants.

- Grants awarded through HUD to local governments to finance substantial rehabilitation or construction of rental housing.
- Intended to increase supply of low-income housing where chronic shortages exist. At least 20 percent of units must be reserved for households with incomes at or below 80 percent of the area median.
- Must remain as low-income, with no condominium conversion for 20 years.

-Grants must be matched at least 1:1, acquisition costs not counted in match.²²

Other HUD programs provide mortgage insurance to facilitate the rehabilitation of one- to four-unit properties as well as multifamily properties. Terms, eligibility, and benefits are generally similar to those programs above.

Description and Evaluation of HUD Programs With Most Rehabilitation Potential

The following programs represent the thrust of current federal housing assistance. They receive more funding and provide more rehabilitation opportunities than previously listed programs. Section 8 certificates, housing vouchers, Community Development Block Grants, Urban Development Action Grants, and Rental Rehabilitation Grants will all be discussed. Unfortunately, most of these programs are not specifically designed for rehabilitation. They usually have broader application, or are not intended for rehabilitation at all.

Section 8 Certificates and Housing Vouchers

The Section 8 program, established in 1974, was intended to assist families in finding private housing.²³ Actual subsidies were calculated on a formula basis as the greater of either 30 percent of the renter's adjusted gross income, or a portion of welfare assistance dedicated to housing expense. While allowable rent rates were not specified, they

fell within a market range for the neighborhood.²⁴

Certificates were intended to make a wider variety of housing available. Even with assistance, however, many tenants did not have the economic means to afford average, market rate housing. It was still necessary to find the least costly accommodations available.

Funds were initially available for new construction, substantial rehabilitation, and moderate rehabilitation. For the first two categories, HUD entered 20 to 40 year agreements with project owners who were typically private, for-profit developers and not-for-profit developers, or public housing agencies. Owners would receive subsidy payments directly from HUD on behalf of the low income tenants. This insured a long-term commitment to affordable housing and insured the rehabilitation of many viable dwelling units. For moderate rehabilitation, HUD entered 15 year agreements.²⁵ Projects were required to accommodate 95 percent very-low income, and five percent low-income.²⁶

By 1982, Philadelphia had approximately 4500 Section 8 assisted units. There were approximately 20,000 more prospective tenants waiting for certificates.²⁷ Like the national situation, demand for certificates far outnumbered available supply. Supply has not been increased since the government stopped building public housing in 1983. Rental assistance does not provide new units. Instead, it only subsidizes rent payments. Thus, simply providing rental

subsidies does not promote rehabilitation.

Housing vouchers, a rental subsidy similar to Section 8, offer a cash or cash equivalent payment directly to very-low-income renters, those below 50 percent of the area median. Subsidies are calculated as the difference between 30 percent of the tenant's adjusted income and the HUD-determined "payment standard," or fair market value for a given neighborhood. This automatically sets a tenant's monthly obligation at 30 percent of his monthly income, provided his unit is priced at the fair market rate.

The tenant is not restricted by location or rental rate. He is permitted to find any reasonably priced accommodations, but the subsidy is still limited to the formula price based on the neighborhood's average housing costs. If he chooses more expensive housing, he must pay the additional cost above the predetermined amount. If he finds less expensive housing, he may pocket the extra subsidy not spent on rent.²⁸

Vouchers offer two important improvements over Section 8. Section 8 certificates made payment contracts between the landlord and the administering agency. Housing options were limited to participating landlords. With vouchers, payments are made directly to the household. The tenant can choose from a larger stock of housing. The second advantage regards monthly payments. Section 8 certificates did not allow the option to rent more or less expensive units. The holder of a voucher has the option to commit more or less

than 30 percent of the payment standard, if he prefers more or less expensive accommodations.²⁹

Unfortunately, experience has shown that cash subsidies in the form of vouchers are frequently used for expenses other than housing. The earliest study of housing vouchers, the Experimental Housing Allowance Program, began in 1970. Its results indicated that only a small percentage of the payment was used to increase housing consumption. Where housing markets were tight, improved mobility did not occur. The voucher program did not open up new neighborhoods and housing opportunities. Those who were not eligible, mainly because they lived in substandard housing, did not generally improve their home or move, in order to receive the voucher. The worse housing conditions became, the fewer households participated.³⁰

The program did alleviate gross rent burdens for many recipients. Where mobility was easier, more money was typically spent on housing and improving overall standards of living. In one experimental site, gross rent burdens dropped from an average of 40 percent to 25 percent.³¹

Despite limited success, the program has other shortcomings that conflict with rehabilitation objectives. Mainly, it does not promote rehabilitation, but only subsidizes rental payments. Aid to renters is more direct than with Section 8, certificates. However, the shift from project-based subsidies to tenant-based subsidies, indicates

an alarming change of policy. As existing contracts expire, many units can be expected to convert to market rate, or be lost for other reasons. Expiration of contracts can be expected soon. While contracts are granted on 40-year terms, they are eligible for prepayment after 20 years. After repayment, the low-income retention obligation is removed. The 20 year period will be expiring soon on many available units.³² Vouchers and certificates do not alleviate this situation as construction and rehabilitation programs would. Simply subsidizing rent without providing additional units is short-sighted. It presupposes a constant, if not growing supply, supply of affordable units. In reality, the supply is shrinking, and the competition for less expensive housing is increasing.

Section 8 certificates and vouchers currently help two million low-income households. Certificates helping 300,000 households will expire by the end of 1991. Another one million will expire by the end of 1994.³³ If contracts are not renewed, the units are lost and the resources that went into building them will no longer benefit the most needy individuals. It is estimated that renewal of all Section 8 certificates and vouchers contracts, under the same conditions, would cost \$24 billion for 1991, and \$73 billion in 1994.³⁴ What the situation calls for is a serious commitment to increasing the total number of units, regardless of the program's mechanics.

Certificates and vouchers also fail to address the quality issue. While these programs do require minimum health and safety standards for eligible units, they are not structured to produce quality units, or effect repairs on substandard units. In the scramble to find affordable units, tenants will be forced to accept less than adequate conditions, and excessive cost burdens.

Community Development Block Grants

In 1974, the federal government adopted a new approach to disbursing funds at the same time it was structuring tenant-based subsidies. The government instituted Community Development Block Grants (CDBGs). HUD previously kept close control over how its funds were spent, insuring that economic and social objectives were being met. HUD generally granted on a per project basis.

CDBGs were established in 1975, under Title I of the Housing and Community Development Act of 1974.³⁵ They were designed to assist communities in planning, economic development, community revitalization, and improved facilities and services. Policy objectives were deliberately broad, allowing the community to determine how the money is spent. Certain stipulations require funds to be spent on activities benefitting low- and moderate-income families. At least 51 percent of the grant must be spent within three years.³⁶ Funds are used for housing and economic development,

including property acquisition, rehabilitation of residential and non-residential buildings, providing public facilities, addressing blighted areas, and improving infrastructure. CDBGs may be used to attract for-profit groups engaging in economic development projects. Cities as well as urban counties with populations above 50,000 are automatically entitled to receive CDBGs on a formula basis, provided they conform to certain eligibility criteria.³⁷

Block Grants permit less federal oversight and greater autonomy for the receiving state or city to apply money where it is most needed. Programs better reflect their jurisdictional interests. The federal government dictates minimal guidelines to insure that broad policy objectives are met. The actual funds, however, receive minimal restrictions.³⁸ Federal administrative costs are reduced in the process.

CDBGs address community revitalization objectives by stimulating vital economic activity, building housing and infrastructure, and drawing private investment. Block Grants finance programs that create permanent and construction jobs and additional tax revenues. They give greater autonomy to state and local government, and reduce federal administrative costs. Block Grant programs however, are not without problems. Critics question whether broad revitalization objectives are achieved.

The CDBG program acknowledges the need for a strong

housing component. It is generally the largest usage of CDBG funds. In 1981 and 1982, approximately 36 percent of total CDBG appropriations went to residential rehabilitation. The figures for 1982 were estimated at \$1.3 billion for housing, out of the \$3.5 billion appropriation. This reflects a high priority and commitment placed on housing at the state and local level. The CDBG program also illustrates the federal government's emerging commitment to preserving existing urban fabric. Beginning in 1975, CDBGs contributed to conserving and rehabilitating existing housing stock for low-income residents. Using CDBG funds for new, residential construction was prohibited.³⁹ CDBGs are especially viable because of their flexibility and use for broad-based community revitalization. Money is applied to projects at the discretion of the municipality.

The future of CDBGs is less certain. In recent years, CDBG entitlements have been cut.⁴⁰ Philadelphia's entitlement decreased from \$51.2 million in 1990, to \$48.6 million in 1991.⁴¹ The entitlement is down from a peak of \$72.4 million.⁴² While some of the shrinking entitlement may result from declining population, national appropriations have declined as well.⁴³ Despite reduced funding, the program's structure makes it extremely valuable for rehabilitation and all facets of community revitalization. Further funding cutbacks could have a detrimental effect on the future of inner cities.

Urban Development Action Grants

The Housing and Community Development Act of 1974 also authorized a program to provide assistance specifically for distressed communities. Urban Development Action Grants (UDAG) were established in 1977, to "help alleviate physical and economic deterioration."⁴⁴ They promoted the philosophy that private resources and commitment were crucial to solve major, urban problems. UDAGs were intended to act as catalysts for economic development activity in severely depressed neighborhoods. By guaranteeing federal assistance, the program would foster public/private partnerships, attracting investors, lenders, foundations, and other private interests. An added benefit would be the jobs, tax revenues, and private investment that projects would deliver. A larger mix of commercial and industrial projects were required, but residential projects were also built.

Economic distress was measured with a combination of factors. Eligibility was based on the presence of certain conditions, such as aged housing, low per-capita income, high poverty, loss of population, the extent of growth lag, and unemployment. If metropolitan cities or urban counties met these conditions, they could apply for grants.⁴⁵ Recipients were required to comply with other program guidelines. In order to stimulate private investment, projects needed a match of \$2.50 for every one dollar of UDAG funds. Private

commitments had to precede UDAG commitments. Projects could not exceed four years in duration. With CDBGs, a state or local government received one lump sum to distribute as needed. It was generally applied to multiple projects. UDAG grants however, were awarded for single projects. Often, funds would supplement a CDBG project. One municipality could apply for multiple grants, provided each project met eligibility criteria.⁴⁶

The program was expanded in 1979 to address "pockets of poverty" in non-distressed cities. Twenty percent of funds were reserved for such cities. Funds went only to low- and moderate-income households. Local government provided a 20 percent match.⁴⁷ The program was further refined in 1981. It no longer required a specific mix of commercial, industrial, and residential projects.⁴⁸

A significant portion of UDAG funds were devoted to housing. In its first four active years, from 1978 to 1982, approximately 25 percent of approved, UDAG projects contained new construction or rehabilitation of residential units. A shift towards rehabilitation over new construction took place. The shift probably reflected a growing preference towards rehabilitation over new construction, since no restrictions specifically favored rehabilitation. Approximately half of all UDAG assisted units cater to low- and moderate-income households.⁴⁹

In the first seven years of UDAG, approximately 95,000

residential units were built. They were divided approximately equally between new construction and rehabilitation. Thirty-nine percent were reserved for low- and moderate-income households.⁵⁰ It also encouraged \$20 billion in private investment, representing a 5.6 to 1 matching of outside funds to UDAG funds.⁵¹ Its project-based nature suits the needs of partnerships well. A single UDAG grant could be tied to a specific project, instead of competing for a share of resources under a larger Block Grant. More recent activity from UDAGs has been limited. The program faced severe funding cuts throughout the 1980s.⁵² As with many similar programs, its future is uncertain.

Rental Rehabilitation Grants

Rental Rehabilitation Grants were established in 1983, under the U.S. Housing Act. In this program, which directly addresses substandard housing, HUD grants funds to cities and states to encourage rehabilitation. It also offers rental subsidies to low-income tenants choosing to stay in rehabilitated units, as well as relocation assistance to those who move. Like other grants these are designed to attract private financing of rehabilitation. Grants are awarded on a formula basis to communities of 50,000 or more. Funds rarely exceed \$5000 per unit. They only require a one-to-one match from outside sources. Eligible rehabilitation work is limited to correcting substandard conditions, necessary improvements, major system repairs and energy

related improvements. Seventy to 100 percent of the resources must go towards low- and moderate-income renters.⁵³

Rental rehabilitation grants are beneficial for addressing substandard housing, and for requiring low- and moderate-income beneficiaries. Too many programs end up benefiting wealthier residents instead of the lowest groups that they were designed for. Larger amounts should be dedicated to each unit, as \$5,000 may not be enough to bring the unit to code. The benefits of rental rehabilitation grants should be further exploited.

State Sponsored Programs

State governments have recently gained prominence in the area of community revitalization. States have increased direct involvement and authoritative control. States have intervened in programs that previously bypassed them, going directly from federal to local government. States have filled in for waning federal management. It may be too early to measure their effectiveness. However, increased state participation should be beneficial.

Increased involvement has resulted from a number of circumstances. America's changing industrial and employment structure requires adaptation on all levels. Changing demography has shifted housing burdens between states. A general resurgence in state government has increased their viability. States are becoming more sensitive to housing and

development issues. Finally, significant cutbacks in federal funding have compelled them to participate.⁵⁴

States have increasing control over monetary resources. Federal block grant programs, especially CDBGs, are often granted through state agencies. States are responsible for determining need, identifying projects, and allocating money. State control reduces federal administrative expense. The larger benefit, however, is better targeting of funds. State and municipal governments are better positioned to utilize resources most effectively.

In addition to CDBGs, states are allocating more of their own resources to housing.⁵⁵ This surely is in response to ongoing housing needs and reduced federal assistance.

All states have established an administrative entity with housing and community development responsibilities.⁵⁶ These agencies can develop innovative programs to suit their specific needs, target eligible recipients, and coordinate the diverse pool of resources and players. Over 300 new state housing programs have been developed nationwide. All but two states have tax exempt bond programs to finance home ownership and rental housing.⁵⁷

To be a viable, sustained partner in the housing market, state government must keep up with new trends in housing development. They must achieve a high level of competence and proficiency in areas where they were previously less involved. Industrial development and better housing are seen

as critical components to economic viability, especially for older states like Pennsylvania. Physical resources must be transformed and upgraded to stay competitive in a broadening market place.

States are involved with innovative programs designed to develop low- and moderate-income housing. These include loans, grants, rehabilitation programs, and housing trust funds, all administered and financed on the state level. Many such programs, though not all, promote rehabilitation. A housing trust fund, operated on a state or local level, will be discussed in greater detail.

Other programs are designed for special interest groups. California, for example, has programs for migrant farm workers. Many states have programs for the elderly, and ill. Alternative living units such as single room occupancy (SRO) buildings, congregate care, emergency shelters, and multifamily units all receive increasing state resources. States also have grant-in-aid programs, rent and mortgage subsidies, and low interest loans. Programs are designed to reduce fees, expedite permit processing, combat low-density zoning, and minimize obstacles to low-income housing.⁵⁸

Money comes from various sources. Part comes in direct appropriations. States also earmark specific funds for housing programs, such as transfer taxes or surcharges. The money goes into trust funds where grants are made to public agencies or not-for-profits which administer programs.

Locally Sponsored Programs

Local governments have traditionally been more directly involved than states. Local housing initiatives have increased by dramatic proportions in recent years. Like state involvement, localities have initiated traditional and innovative programs to increase the supply and quality of affordable housing. Municipalities are adopting a more business-like or "entrepreneurial" approach.⁵⁹ Distinctions between private interests and local, public agencies are blurring as they combine efforts more frequently, and more successfully. Housing and community development in particular foster strong public/private partnerships, with public entities often playing the central role.⁶⁰ Local governments are often on equal footing with state and federal agencies.

Strong, well conceived plans at the local level are extremely important. Solid management and commitment to housing at the local level may influence a program's success or failure more than most other factors. The arsenal of mechanisms is growing, but by no means complete.

Through the 1960s, local participation was almost exclusively related to federally-mandated programs. Local public agencies such as housing authorities and redevelopment agencies would administer slum clearance, public housing, urban renewal, and other projects. They were usually

directed by governmental oversight and bureaucracy. As the 1970s introduced less restricted funding sources and greater demand on local administration, municipal governments began increasing their responsibility. When the federal government discontinued public housing production in 1983, municipalities were forced to produce housing with less federal guidance and funding than ever before. The future viability of many cities depended on their ability to adapt to increasing demand, rising development costs, and less federal assistance. Many cities found alternative and innovative means to financing public and private housing.

Significant, monetary contributions from local government are limited. The majority of Philadelphia's housing assistance comes from federal block grant funds, federal rental rehabilitation funds, and state sources. Very little comes from the city's capital budget.⁶¹ Municipalities may provide minimal financing to a project. Instead of direct appropriations, municipalities can structure tax incentives, regulatory programs, and locally sponsored initiatives. Many of these will be discussed in upcoming chapters.

Non-Governmental Programs

The increasing popularity of private investment is a healthy trend in low-income housing. This section will review sources of non-governmental funds. Fortunately, many

private sources promote rehabilitation, reflecting a preference towards protecting the existing environment.

Much of the funds raised from private sources come from large, socially and culturally minded institutions. The National Trust for Historic Preservation has numerous funds benefiting affordable housing. National foundations are another prolific source. Money from these sources usually goes to small, public and private development corporations. Since these funds do not carry governmental strings, they can be applied to a wider array of project needs. They are used in conjunction with land trusts, linkage programs, surveys, seed money, and more. Participation by these institutions represents the same advantages that public/private partnerships bring to rehabilitation. It spreads the risk of investment. It broadens the developer's responsibility. It introduces new talent and expertise. It also builds a greater commitment to success. The major sources will be examined.

National Trust Programs

The National Trust for Historic Preservation offers four financial and technical assistance programs. The programs are similar but address different aspects of the housing rehabilitation process. The Inner City Ventures Fund (ICVF) was established in 1981 for certified rehabilitation work. It is the largest National Trust program. Projects must benefit low-and moderate-income residents through not-for-

profit community organizations like CDCs. It provides funds for diverse projects including housing, commercial space, SROs and industrial conversions. Funds can be used for acquisition, certified rehabilitation conforming to the Secretary of the Interior's standards, and other capital costs. Projects must be listed or eligible for the National Register.⁶²

Though awards only range between \$40,000 and \$100,000, they are good for leveraging because they offer an early commitment to participate and a 5:1 matching fund requirement. Local sponsorship is achieved through a requirement that applications come from neighborhood based not-for-profits.⁶³ Half of the funds go to grants, the other half for low-interest loans and technical assistance. The maximum loan term is five years.⁶⁴

ICVFs have successfully initiated many projects. From 1981 to 1987, \$2.9 million in funding went to 45 projects,⁶⁵ and built 1200 residential units in 229 historic buildings. It also built 467,000 square feet of storefronts, business space, and community meeting space. ICVF's employment objectives were met with 1000 construction and permanent jobs created.⁶⁶ By leveraging \$17 for every ICVF dollar, projects totaled \$52 million. Matching fund objectives were met by attracting funds from many sources including:

- CDBGs
- State loans and grants
- City loans and grants
- Loans from the seller

Foundation grants
CDC loans
Syndications from investors
Bank loans
FNMA
LISC Grants
Private contributions
Other sources⁶⁷

The ICVF program was itself developed from a seed grant from the Department of the Interior, the National Trust, and private support. The original \$400,000 grant is now part of a \$4.5 million fund.⁶⁸

The second National Trust program is the National Preservation Loan Fund (NPLF), established in 1971. NPLF provides low interest loans to assist organizations in creating or expanding revolving preservation funds. It is also used to initiate real estate development projects to preserve historic buildings, sites, and districts. Funds can be used for acquisition, certified rehabilitation, and other capital costs.⁶⁹

The maximum loan amount is \$100,000, with interest set at two points below prime, for a maximum term of five years. These loans only require a 1:1 match of funds. Not-for-profit corporations and public agencies are eligible. \$9 million has been lent to date.⁷⁰

The Preservation Services Fund (PSF) was established in 1969. It provides small matching grants for preliminary work on potential rehabilitation projects. Eligible recipients are not-for-profits and public agencies. Funds are not used

for "bricks-and-mortar" construction. Instead, they are for services such as professional consulting, educational programs, conferences, rehabilitation feasibility studies, and seed grants to plan the reuse of historic buildings. Grants range from \$1,000 to \$5,000.⁷¹

The Critical Issues Fund (CIF) was established in 1980. It too is a matching grant program designed to fund research or model projects addressing preservation problems. It focuses specifically on economic development, growth management, affordable housing, and tourism. Not-for-profit groups, public agencies, and national organizations are eligible to apply for grants ranging from \$5,000 to \$25,000.⁷²

Foundation Funds

Many national and local, charitable foundations have community development objectives. They are a viable source of funding.⁷³ While grants are not generally large, they look favorably on rehabilitation projects. They often provide technical assistance and act as quasi-developers. Using their influence, such foundations can be effective at channelling reluctant, private resources into local housing.⁷⁴

One of the more prominent foundations is the Ford Foundation. It funded the Local Initiative Support Corporation (LISC). LISC makes early grant and loan commitments to attract corporate backers. It assumes a development role by arranging additional financing to structure complicated deals. It also assists in design and

management of properties. LISC's activities effectively persuade private initiative.⁷⁵ Other active foundations include the Enterprise Foundations, established in 1981, and the Neighborhood Reinvestment Corporation, established by an act of Congress, in 1978.⁷⁶ The Neighborhood Reinvestment Corporation acts as an umbrella organization of neighborhood housing services. As of 1989, it served 137 cities.⁷⁷ The Bridge Corporation is a San Francisco based, not-for-profit group providing large quantities of low-cost housing, mixed with market rate units.⁷⁸ In Philadelphia, two locally based foundations support rehabilitation efforts, The Pew Charitable Trust and the William Penn Foundation.

It is worth noting that banks and corporations are increasing their commitment to housing. In 1972, the Federal Bank Holding Act encouraged parent banks to set up development corporations to invest in jobs and economic development in low-income neighborhoods.⁷⁹ Private corporations have initiated housing programs on their own. They have funded low-income housing for employees near their plants. There are examples of companies providing surplus buildings or land for building or housing with a \$1 per year lease.⁸⁰

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CHAPTER 6

TAX INCENTIVE PROGRAMS

Tax Incentive Programs

Tax incentives are a major source of financing for rehabilitation. They offer direct, monetary assistance to an organization engaged in qualified rehabilitation activity. Not-for-profit CDCs can benefit from tax incentives because of a rule reserving 10 percent of tax credit funds for not-for-profit organizations that materially participate in low-income development.¹ For-profit investors in the partnership can take the credit. Tax incentives reward the taxpayer indirectly, as money saved, not money received in a literal sense. Any qualified individual or organization may take advantage of them. Conversely, grants, subsidies, and loans are limited in quantity and more difficult to obtain. They require approval. While not without inherent shortcomings, tax incentives are the prevailing method for attracting private investment in rehabilitation. The focus of this

section is an analysis of the historic rehabilitation tax credit, the low-income housing credit and, differential assessment for the rehabilitation of affordable housing.

Investment Tax Credits

The fundamental purpose of the historic tax credit is to promote the rehabilitation and use of architecturally and/or historically significant, income-producing buildings. This credit is extremely important since housing accounts for approximately 45 percent of tax credit projects.² The low-income housing credit promotes rehabilitation and construction of affordable, rental housing and promotes assimilation of lower-income groups with other segments of society. Both credits provide incentives to would-be investors in the form of a dollar-for-dollar reduction of tax liability. For example, if a taxpayer invested in a tax credit project and claimed a \$5,000 credit, his year-end tax liability would be reduced by that same amount.

As the tax structure stood before 1986, there was great potential to shelter large amounts of income through real estate investment. Real estate investment enjoyed favorable tax rates on capital gains, and accelerated depreciation schedules. Policy makers concluded that credits had become an enormous tax shelter for wealthy individuals, even though thousands of buildings were being rehabilitated. The Tax Reform Act of 1986 revised the tax code by reducing the

attractiveness of real estate investment as a tax shelter. The 1986 tax code removed accelerated depreciation schedules and favorable tax rates on capital gains. The most harmful effect was the institution of passive loss rules. Passive loss rules made it impossible for wealthier taxpayers to shelter earned or portfolio income, and set limits on the amount of credit eligible taxpayers could claim. It resulted in less low-income housing and less private investment activity in rehabilitation.³ With less credit available, many projects lost their economic feasibility. Most recent revisions of the tax code have restored part of the low-income credit's appeal, but not the historic credit.

Tax credit projects have tended to be small in scope. Up to 1986, over 80 percent of commercial historic rehabilitation projects were financed for less than \$1 million. Almost 40 percent totalled less than \$150,000.⁴ This trend continued after the 1986 changes. Medium sized projects, between \$500,000 and \$5 million became hardest to finance.⁵ Smaller projects could still be financed through a small group of investors meeting the income requirements. Very large projects were usually financed through public offerings, pooling many small investors. A shift from limited partnerships to individual or corporate ownership occurred as well.⁶

The basic structure of tax credits must be explained. For the purpose of claiming a credit, income is divided into

three categories, active, passive, and portfolio income. Simply stated, active and portfolio income refer to salary or wages and interest or dividend, respectively. Passive income (loss) is defined as an activity or business in which the taxpayer does not materially participate, but is a limited partner. Investment in rental property that is not one's primary source of income is considered passive regardless of material participation.⁷

Losses from passive activity, such as qualified rehabilitation, can only be applied to offset active or portfolio income up to a maximum of \$25,000 per year. This benefit is only available to taxpayers with gross adjusted earnings under \$250,000. An eligible taxpayer may also offset non-passive income with rehabilitation losses up to \$25,000, provided his adjusted gross earnings are under \$150,000.⁸ Offsetting income by \$25,000 per year, in the 28% tax bracket, amounts to a maximum benefit of \$7,000 in after-tax savings.

Historic Rehabilitation Credit

The rehabilitation tax credit provides a 20% credit for qualified rehabilitation of income-producing buildings listed on the National Register, and placed in service before 1936. Similarly, it offered a 10% credit for non-listed, income-producing structures, placed in service before 1936. Qualified rehabilitation expenditures include construction costs. Acquisition and enlargement costs are not covered. Qualified rehabilitation employs an exterior wall test which

requires at least 75 percent of exterior walls and internal structural framework to remain.⁹

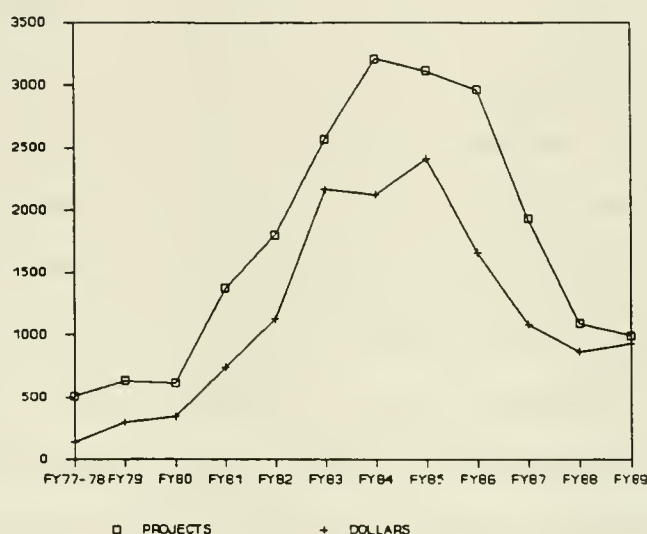
The \$250,000 income cap unnecessarily restricts those wealthy investors who, prior to 1986, traditionally invested heavily in real estate. If the spirit of the legislation is to provide reasonable economic incentives to investors, then it should be structured to include wealthy investors as well. Excluding them only defeats the purpose of promoting rehabilitation.

The proposed Community Revitalization Tax Act of 1989 (the Act) attempted to address restoring rehabilitation tax credit activity to pre, 1986 levels. It would have removed rehabilitation and low-income housing activity from passive loss rules.¹⁰ The Act would have permitted taxpayers to increase the maximum credit claimed from \$7,000 per year to \$20,000, plus an amount equal to 20 percent of any additional tax liability.¹¹ The Act would also have removed the \$250,000 income eligibility cap on the rehabilitation credit, thereby increasing the pool of investors and the availability of financing.¹² In addition, it would encourage more coordinated use of the two existing credits, and cooperative ventures between profit and not-for-profit organizations.¹³ However, no action has been taken on the Act through the end of March, 1990.¹⁴

Despite its post 1986 shortcomings, the program has generated significant rehabilitation activity. Since its

beginning in 1976 to the end of fiscal year 1989, approximately 21,000 projects with an investment of \$14 billion have been certified. Rehabilitation activity hit the high-water mark in 1984. Maintaining a high level plateau until 1986, projects began declining mainly as a result of the Tax Reform Act of 1986.¹⁵ The chart below summarizes projects approved and dollars spent on rehabilitation projects nationally:¹⁶

Approved Rehabilitation Projects and Investment



	FY77-78	FY79	FY80	FY81	FY82	FY83	FY84	FY85	FY86	FY87	FY88	FY89
Projects Approved	512	635	614	1,375	1,802	2,572	3,214	3,117	2,964	1,931	1,092	994
\$ Invested (Millions)	\$140	\$300	\$346	\$738	\$1,128	\$2,165	\$2,123	\$2,416	\$1,661	\$1,084	\$866	\$927

*Figures are estimated maximum private investment, assuming all approved projects are completed.

Growth of the program was dramatic in the early 1980s, holding fairly steady until 1986. Changing the tax code caused the number of projects to drop from 3214 in 1984, to

less than one third that figure, or 994 in 1989. The dollar amount spent did not drop as severely. It stabilized at slightly less than half peak levels.¹⁷ This alarming trend must be reversed if the government is to promote the greater objectives. As it stands, construction costs must be modest and local income levels must be stable, at a fairly high level, for low-income projects to be economically feasible.¹⁸ Unfortunately, this situation rarely occurs.

Pennsylvania has utilized the historic rehabilitation tax credit more than any other state. From 1982 to 1985, it led the country in both the number of approved rehabilitation projects and the amount of rehabilitation investment.¹⁹ Jobs were created and thousands of units were rehabilitated as a result.²⁰ Activity then dropped significantly through 1988.²¹ Much of Pennsylvania's success came from the heavy utilization of credits in Philadelphia and Pittsburgh. Philadelphia ranked first among the major cities in the amount of investment, and fourth in the number of projects. Pittsburgh ranked well in both categories as well.²²

The current tax code is designed to afford only nominal assistance to real estate development. Projects must be profitable without the credits. An obvious and unfortunate result is that affordable housing has been forced to become more profit-motivated than is realistically feasible. A more effective credit would offer better incentives with equitable distribution, to private investors. Instead, housing has

shifted from a highly subsidized government service to a profit motivated venture. Low-income housing should receive greater assistance. Clearly, a profit oriented framework is inappropriate and unfeasible.

Low-Income Housing Credit

The low-income housing tax credit is among the most important components for residential, rental rehabilitation. The majority of recent projects would not have been completed without the tax credit. It takes the form of three individual credits claimed on a straight-line basis, annually for 10 years: nine percent for new construction and substantial rehabilitation, four percent for new construction and substantial rehabilitation financed with tax exempt bonds or similar federal subsidies, and four percent for acquisition costs.²³ The nine percent rehabilitation credit and the four percent acquisition credit may both be claimed. Since this study focuses on rehabilitation, the new construction component will not be addressed. (To calculate the credit, see Appendix A).

A developer who applies for the credit must guarantee that he performs "qualified rehabilitation" work and rents units as "low-income." To insure that units are rented as low-income, an owner must impose income targeting thresholds. (See Appendix B). Income targeting and qualified rehabilitation are both designed to promote the objective of stable, economically integrated, community development. To

further that same objective, projects must continue to satisfy low-income requirements for a compliance period of 15 years.²⁴

If a compliance violation is corrected within a reasonable period of time, a property owner will not be penalized with a recapture of credits. A particular tenant's income may rise by 40 percent and still qualify as low-income. Without such a provision, owners could be forced to evict tenants in order to maintain a proper balance of renters. Even under the current rules, landlords must regulate tenant income closely, replacing low-income renters with similar renters.²⁵

In December of 1989, the U.S. Congress voted to extend the low-income housing credit for one year. The \$250,000 income cap was removed. All taxpayers, regardless of income, are eligible to claim the credit. However, there were also detrimental changes to the credit. Funding, which is awarded to states on a per person basis, was reduced. Previously, individual states could authorize \$1.25 in low-income credits, per person.²⁶ The December, 1989 vote reduced that figure to 75 percent of earlier levels.²⁷ Preference was given to the lowest-income projects.

Differential Assessment

Differential assessment is a method of protecting endangered farmland and providing relief to farmers. Since farmland on the exurban fringe experiences strong development

pressure, a program has been devised to compensate farmers with tax savings so they are less inclined to sell their land out of farming. Using taxation to promote a certain desired behavior is hardly new to rehabilitation efforts. To the author's knowledge, differential assessment has not been used in the context of affordable housing. However, the potential application to rehabilitation is worth reviewing.

Differential assessment has three forms. Preferential assessment allows land to be assessed for taxes at the lower current use value instead of the greater fair market value for as long as the land is in farming.²⁸ The second form, deferred taxation, is similar to the form above. The owner, however must pay back the amount of tax savings that he was excluded from paying if land is converted to a non-eligible use.²⁹ The recapture of back taxes however, may be held constant for a limited number of years. The longer land is retained in farming, the more years of savings he will accumulate.³⁰ The third alternative, a restrictive agreement, adds to the deferred taxation form by imposing additional requirements on the land. For example, a farmer must signify his intentions to renew his differential assessment or withdraw after a certain period of elapsed time.³¹ This requires a farmer to restrict his land for greater periods of time. Each of the three plans become more restrictive to the landowner, but more equitable to neighboring ineligible landowners. The intricacies of the program are complex and

not directly related to this study. Potential applications to the affordable housing in the urban setting will be discussed.

Differential assessment could be applied in the case of rehabilitation leading to higher density zoning. It is not uncommon for low-income neighborhoods to have an extensive collection of large, abandoned homes. Built and zoned for single family, they are perfectly suitable for rental conversion. As high density, low-income housing, land assessments could potentially rise. Differential assessment could be used as a method for reducing total operating expenses. Property taxes would be kept at current use value instead of raising to high density usage. By using the deferred assessment form, private property owners would continue to save while their property was low-income.

The same concept of deferred assessment could be applied to all affordable housing. A program could be structured to assess affordable housing at a lower rate, thereby reducing operating expenses through property tax savings. Owners save on property taxes as long as they retain low-income usage. Urban applications to differential assessment would require significant changes to a farmland program. For example, the farmland program generally gives differential assessment in land, not improvements, or buildings.³² For urban settings, the assessment must include improvements, as buildings occupy virtually the whole site. While such a program may not have

broad application, it could certainly promote significant savings and low-income retention given the proper circumstances.

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CHAPTER 7

REGULATORY PROGRAMS

Linkage

Local governments have recently resorted to the concept of linkage as a method for raising funds from commercial developers. Developed in the 1980s, linkage is a method of alleviating some adverse impacts of large-scale, commercial development, by connecting housing requirements to such development.¹ Quite simply, developers are obliged to participate in community revitalization programs because of the need created by their commercial buildings.

They may be an active partner in a joint venture, provide a payment in fee based on square footage of office space, or a combination of the two. Other community revitalization initiatives include job training, day care, neighborhood employment, and related services. The linkage obligation can be fulfilled by providing amenities without direct benefit to low-income neighborhoods. Public plazas, public art, and

additional parking are typical amenities.² They relate more directly to the business district where the office space is located. Such amenities typically earn developers bonus "points," allowing them to build above the zoning envelope. The more costly revitalization or amenity packages naturally permit greater increases in floor area ratio (FAR). The greatest benefit, however, comes from linkage promoting rehabilitation.

Boston's linkage program requires a \$5 per square foot contribution for all development over 100,000 square feet. The money is placed in a housing trust fund benefiting low-income housing.³ San Francisco's program gives developers three options. They may build affordable housing themselves, or contribute funds to either a specific housing development or an affordable housing trust fund. Most developers have opted for contributions to another housing project. No developers contributed to a fund, and few built units themselves.⁴

Philadelphia is considering a program linking commercial office development to public amenities or protection of historic buildings.⁵ The proposal would allow office buildings to increase their as-of-right FAR with on-site improvements such as public, outdoor plazas, enclosed public space, gardens, public art, observation decks, underground parking, transit stop improvements, or similar public amenities.⁶ As an alternative to public amenities, developers

could increase FAR with the purchase transfer of development rights (TDR). This is suitable for smaller buildings which are less able to sacrifice rentable space. Development rights would be purchased from historically certified buildings. Many historic buildings do not fill the allowable zoning envelope. Building additions would destroy their architectural integrity. However, restricting expansion is a denial of property rights. TDRs would allow commercial developers to purchase development rights from historic building owners. Commercial developers can then increase FAR, and historic building owners are compensated for the loss of their unused development space.

Beyond inherent problems with bonus amenities and TDRs, Philadelphia's proposed program would only link increased FAR to needs created directly by the building in question. There are no increases in FAR for improvements such as affordable housing, day care facilities, and job training. Increased need for these amenities cannot be directly attributed to more center city office space. Therefore, the ordinance would not require improvements of this nature. It is admittedly more difficult to justify off-site improvements. Developers would argue that larger office buildings do not directly create the need for better housing in the inner city. However, such a program is in place in Boston and San Francisco. Philadelphia should consider an affordable housing link as well.

Linkage programs are not without difficulties. Their

connection to commercial office space can be problematic. The building boom has nearly ended. Vacancy is increasing and development is predicted to slow in the 1990s, leaving fewer linkage opportunities available. Linkage is less successful when buildable space is easily acquired. In that case, developers are less inclined to make concessions to acquire additional FAR. Programs have been legally challenged as well. There must be strong connections established between commercial development and the need for affordable housing it creates.⁷

Land Trusts

A land trust is not a specific program like others reviewed. Instead, it is a pool of funds and resources earmarked for special purposes. In this case, the purpose is generally financing acquisition, construction, and rehabilitation of low- and moderate-income housing. In 1988, 16 states and 12 municipalities adopted a housing trust fund. Most have been established within the last three years, either through a legislative body or an administrative action.⁸ Most local trust funds are administered through public agencies, but allocations are controlled by special boards or not-for-profit corporations.⁹

Sources of funds are varied. The state often provides funds through appropriations or dedicated revenues.¹⁰ Some states provide funds from more unusual sources. Surplus

revenues from the State Housing Finance Agency, surcharges on documents filed with the Recorder of Deeds, and revenues from delinquent loan payments, penalties, fees, and charges all contribute to housing trusts.¹¹

As mentioned earlier, local contributions are received through exactions from private developers through linkage programs. Municipalities receive funds through impact fees on rental-to-condominium conversions, real estate transfers, and demolition permits. Proceeds from urban renewal sales are used to capitalize funds. CDBG grants, matching governmental grants, and private donations account for trust contributions.¹² Taxes are even placed on unrelated items such as cigarettes to raise revenues for housing.¹³ Real estate transactions, especially those that reduce the affordable inventory, should be categorically taxed. Revenues should go directly to housing trusts or specific projects.

One specialized program of land banking comes from Nantucket, Massachusetts. There is a real estate transaction tax of approximately two percent. The money is used to protect Nantucket's natural and scenic environment by protecting open space and slowing the pace of development. Part of the money raised is earmarked for affordable housing.¹⁴

The main problem with trust funds is the lack of steady sources of funding. Mandatory contributions are rare. Dedicated sources are often tied to a shifting or erratic

revenue base. Depending on an steady, consistent, and substantial flow of revenues is impossible. Even direct allocation of state funds may never be appropriated.¹⁵

Urban Homesteading

Urban homesteading was established under the Housing and Community Development Act of 1974.¹⁶ Under the program, federally owned properties are transferred to local governments, which, in turn, transfer properties to eligible applicants, called homesteaders. A nominal fee is charged, including settlement fees. Eligibility criteria is established to select homesteaders fairly. Selection priority is based on the single criteria that the homesteader must be a "lower-income" person or family.¹⁷ (Previously, the program favored applicants exceeding the 30 percent HUD affordability limit, currently living in substandard housing, or those with little prospect for improvement.)¹⁸ Homesteaders must be able to realistically afford improvements while paying taxes, insurance, and other ongoing expenses. If the homesteader fails to meet any obligations, he must leave the property. Selection of house and homesteader, conveying of titles, and other administrative proceedings can be designated by the state or local government to a "qualified non-profit organization" or a public agency to act as the local urban homesteading agency (LUHA).¹⁹ An established CDC could become the LUHA, gaining direct control over a homesteading program.

The program requires homesteaders to occupy the unit as their principle residence for five years. It must be brought to code within three years. The homesteader may hire contractors or put his own "sweat equity" into repairs. Homesteaders must permit inspection upon completion of rehabilitation. When all requirements have been fulfilled, the homesteader receives fee simple title.²⁰

Urban homesteading provides a simple solution to one of the more ironic housing dilemmas. With the shortage of adequate housing, HUD, other federal administrations, and local housing authorities own enormous inventories of abandoned, single and multifamily units. For various reasons, these houses are not being rehabilitated. The concept behind urban homesteading is to simply give them to "homesteaders," who agree to improve the property in exchange for fee simple title. The benefits include providing an ownership opportunity, removing a property from the abandoned or tax delinquent inventory, and rehabilitating an underutilized property.

Philadelphia was the second city in the country to pioneer urban homesteading.²¹ Though its program is currently dormant for lack of eligible, publicly-owned properties, similar programs with minimal acquisition costs exist.²² One such program is called 1202 A. The City of Philadelphia will transfer title to an eligible recipient on abandoned

properties with delinquent taxes. The original owner will be forgiven of delinquent taxes and liens when the property is transferred.²³ After the title has been transferred, the owner has a one year right-of-redemption period to pay the liens and receive title to the building.²⁴

Homesteading programs usually target specific neighborhoods with high concentrations of HUD-owned properties. Often these are not-low income neighborhoods, because of fewer HUD-owned properties there. The program would be most effective for lower-income participants if a rehabilitation component was automatically included. Homesteading programs can be connected with HUD, Section 312 rehabilitation loans to provide financing for repairs.²⁵

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CHAPTER 8

INCLUSIONARY ZONING

Inclusionary Zoning as a Means to Insuring Equal Opportunities

Housing programs discussed in this study focus on existing, low-income neighborhoods, located primarily in a ring surrounding the center city core. Another dimension of the affordable housing spectrum goes beyond inner city containment. Affordable housing should be addressed as it relates to all neighborhoods. Economic constraints have effectively eliminated alternatives to inner city living such as the suburbs. Poor Americans are virtually excluded from the vast majority of housing opportunities in broad metropolitan areas.

Providing affordable housing is the disproportionate responsibility of inner cities. Many suburban and exurban municipalities have deliberately or inadvertently removed themselves from the affordable market. Three basic causes

exist. Some municipalities want to maintain the spacious, desirable character of current housing type and density, with no intent to characterize inhabitants or exclude any particular group. Other municipalities simply resist growth of any sort. Still, there are municipalities with racially motivated intentions of excluding poor people from their neighborhood. If this is the case, the courts will act swiftly to strike down racially motivated zoning.¹

Since the federal courts hear racially motivated exclusion cases, a consistent, national policy has evolved. Nonracially motivated exclusionary zoning is deliberated on a state level. Thus, a variety of remedies have been mandated. The courts have generally held that providing housing opportunities for all levels of society advances the public welfare. State courts, therefore, have upheld land use regulations that promote affordable housing. This section will focus on nonracially motivated exclusion.

In New Jersey, The state Supreme Court has ruled that all municipalities must provide for their fair share of all housing types, including affordable housing. Recent trends in federal, governmental policy reflects similar thinking. Programs now support dispersion through rental assistance, instead of concentrating dense, low-income development.

Though inclusionary zoning does not directly relate to the rehabilitation of existing low-income neighborhoods, it is an essential component in community revitalization. It

provides a framework for equitable housing opportunities for all neighborhoods. This section will characterize the situation, discuss inclusionary zoning objectives, review the general characteristics of inclusionary zoning, discuss its constitutionality, and finally, examine shortcomings and problems with program design.

Objectives of Inclusionary Zoning

The broad goal of inclusionary zoning is the successful integration of lower-income households within stable, self sufficient, middle class society. Presumably, inclusionary households will benefit from the arrangement without significantly harming "market rate" households. An inclusionary program should achieve three main objectives. It should produce integrated housing developments with affordable and market rate units, it should be legally defensible, and it should be equitable to all involved parties, including developers, market rate home buyers, and other land owners. These three objectives are achieved using the regulatory powers of zoning to bring about desired social benefits.

A shift in the use of zoning, from passively restricting undesired land uses, to affirmatively zoning to promote desired social outcomes, has been upheld by the courts.

Inclusionary zoning impacts both municipal planners and developers. Municipalities must realistically plan for

future development by providing adequate supplies of land for affordable housing. They are also prohibited from excluding such housing, or unjustifiably limiting growth to achieve the same effect. Developers within such municipalities, must actually build a certain percentage of low- and moderate-income units with every new housing development.

Inclusionary zoning critics might question the assumption that integrating low-income residents will benefit them without adversely impacting existing residents. It may be presumptuous to assume that middle class social values and work ethics would influence poorer residents in a positive way. Some might argue that this plan could be detrimental to both groups. The verdict is not out yet. To date, very few inclusionary units have been constructed, let alone studied. Hence, the goal of greater housing opportunities is still a legitimate policy objective.

It is important to recognize that zoning restrictions which increase the cost of properties are not inherently discriminatory, and should not be categorically abolished. Zoning that conforms to a wealth classification is not necessarily suspect on a constitutional level.² It may, however, be immoral and inefficient from a land use perspective. Potential buyers are not restricted on racial grounds, only on their ability to afford a home. Such zoning may only exist in addition to higher density, lower income

units. Exclusion occurs when a municipality fails to provide a diverse spectrum of housing opportunities, favoring expensive units only.

Opening up housing opportunities becomes more complicated when an acknowledged phenomenon is considered. Personal preference to live with people of similar socioeconomic backgrounds accounts for a significant portion of segregation. Some analysts estimate as much as one half of all exclusion results from personal preference.³ Laws should not attempt to eliminate preferentially expressed separation.

The federal commitment to inclusionary zoning is strong. In 1982, The Report of the President's Commission on Housing 200 (1982) required a more compelling standard for exceptions than the previous standard. If a municipality fails to provide adequate resources for affordable housing, it must prove a "vital and pressing governmental interest" for doing so. This is more compelling than the "health, safety, and general welfare standard."⁴ Evidently, government is committed to adopting a stiff mandate which states cannot easily bypass.

Since inclusionary zoning requires developers to build less profitable units, they must be equally compensated for the obligation imposed. If benefits and obligations are not bestowed in the same amount, at the same time, to the same party, one party may receive an unearned reward while another may be denied property value. In addition to balance, it

must set realistic housing prices, include all required housing types, minimize displacement effects, and restrict zoning which precludes low-income housing.

The benefits of an inclusionary program are self evident. Social heterogeneity and the right to decent housing opportunities are hallmarks of equality. Integrated housing should lead to improved access to job opportunities, social services, schools, and municipal services.⁵ Potential economic benefits include better stability and lower crime rates for inclusionary residents.

General Characteristics

In order for incentives to make inclusionary zoning programs politically and legally acceptable, they must fully compensate developers for the burden imposed upon them. Compensation usually comes in a variety of forms. Density bonuses allow developers to produce a greater number of market rate units than zoning previously permitted, in exchange for the inclusion of low- and moderate-income units. Waiving various standards ordinarily imposed on development is another form of compensation. Some inclusionary programs use exactions to require affordable housing as a condition for development. Courts have found these techniques to be legitimate methods of promoting local development policies.⁶

Another inclusionary program feature is control of resale, to retain the unit in the low-income inventory.

Without resale controls, the initial owner would receive windfall capital gains from a unit bought at subsidized rates and sold at market rates. Deed restrictions require owners to sell at a pre-calculated low-income rate.

Program designers must determine the appropriate, affordable unit price for purchase and rent, in their region. They are usually based on median prices in the standard metropolitan statistical area (SMSA). The municipality must also set income levels for eligibility.

In order to utilize density bonuses, planners must apply inclusionary programs to land with substantial capacity for greater density use than current zoning permits. In suburban and rural settings, this requirement may be difficult to fulfill if land already has dense zoning. In inner city settings, rezoning large, single family mansions into multi-family units would have no adverse effect on the environment or infrastructure.

Constitutionality of Inclusionary Zoning

The courts have generally upheld inclusionary zoning legislation as long as it meets certain conditions. There must be a reasonable relationship between the affordable housing desired and the means imposed to achieve it.⁷ The connection may not conflict with the due process or equal protection clauses of the fourteenth amendment, or the taking clause of the fifth amendment. This rational nexus

requirement is a reflection of the 1987 Supreme Court decision of Nollan v. California Coastal Commission.⁸ The courts apply standards designed to judge the relationship's reasonableness. If a legitimate governmental objective is furthered by the regulation, and there is a reasonable relationship between the benefits bestowed and obligation imposed, the ordinance falls within the bounds of due process.⁹

The courts generally reject taking claims, because of built in incentives. A small diminution of property value may be permitted given the state's police power to promote the general welfare.¹⁰

There have been very few successful challenges to inclusionary programs. They are legitimized because they promote the general welfare. They do not constitute a taking of property because developers are compensated. The imposition of land use restrictions is a valid exercise of the police power. However, inclusionary programs are not without fault or shortcomings. Problems have occurred, and relatively few housing units have actually been built.

Problems With Inclusionary Zoning

One of the most significant shortcomings of inclusionary zoning concerns the lack of compulsion to build actual units. A municipality may be required to have an inclusionary ordinance, and low-income units are required if developers

choose to build. Still, no actual mandate exists which requires building low-income units. If a developer faces potential administrative and bureaucratic complications, or the potential for losses due to inclusionary requirements, he may elect to build elsewhere.¹¹ The problem could be alleviated if inclusionary zoning were mandated on a state wide basis. Currently, only New Jersey has a state-wide mandate for some sort of inclusionary provision.

With an inclusionary program, it is difficult to balance benefits and costs in the exact amount, to the exact same recipient, at the exact same time. Without meeting these conditions, the requirement may be subject to various constitutional challenges. It also results in unearned profits, and denied property rights to the various parties. Either will probably lead to timely and expensive litigation. Even if developers are fully compensated, no regulations exist to block him from passing on costs to market rate buyers in a development.

When inclusionary units are built, they often fail to accommodate the lowest-income groups. Higher rents, for middle-income markets, make it easier to cover construction costs. Ordinances generally permit moderate income housing to fulfill inclusionary requirements.¹²

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CHAPTER 9

CONCLUSIONS

The subject area for this analysis was older inner cities with economic and social maladies and aging housing stock. Recent housing policy suggests that long-term improvements in these neighborhoods require broad based community revitalization. Economic development, improved infrastructure, better housing, and a renewed commitment to the community are all essential components. Decent housing is perhaps the most important. Excessive cost burdens, declining inventory, and substandard conditions are major housing deficiencies. The study suggests that federal housing policies of the post-war era, failed to address revitalization, and contributed to the deterioration of inner cities. This study therefore concludes that correcting housing related problems is necessary, but not sufficient, for sustained revitalization of neighborhoods.

The principle argument made is that the housing crisis could be best corrected through practical rehabilitation. Practical rehabilitation insures both the economic feasibility and social value of rehabilitation. It must maintain the built environment's best qualities: its form, character, scale, rhythm, and context. Yet it must tolerate reasonable losses of a building's architectural integrity. Rehabilitation was found to be the most viable alternative for two reasons. Current governmental sources of funds appear to promote rehabilitation over new construction. Second, the preservation perspective also supports rehabilitation for its broad, societal advantages. Preservationists have long held that a continuity with the past, as manifested by the built environment, is essential to planning a healthier present and future. Buildings need not be of national significance to be a community asset. Modifications to current preservation tools are necessary to accommodate economic limitations. With the importance of rehabilitation established, the study outlines a community based approach for achieving it.

The study found partnerships to be an effective mechanism for rehabilitation in the current environment. Local citizens from lower-income neighborhoods can organize as central players in partnerships. All levels of the public sector, plus diverse participants from the private sector can bring expertise and resources to the process. This study suggests that the federal government should supply the majority of

rehabilitation funding. Assistance should be structured to insure that broad policy objectives are met, but oversight and administrative responsibility should be localized, where needs and specific circumstances are known best. Sources of funds must contain reasonable incentives to insure private sector participation. State and local governments should identify needs and structure actual programs. The private sector should actually develop rehabilitation projects.

The study provides an overview of current funding sources. It suggests that programs should promote rehabilitation. It reviews a select group of potentially helpful regulatory programs which could be applied to rehabilitation. Finally, it addresses the containment of affordable housing in inner cities. It suggests that inclusionary zoning legislation would better disburse affordable housing by promoting equitable distribution.

Clearly, the United States faces a deep rooted housing crisis. The situation is complex and difficult to rectify. This paper attempts to address the issue from one particular perspective. It suggests that practical rehabilitation is the best alternative. It presents a particular method and a rationale for using it. Given the enormity of the problem, no single method is universally applicable. The intent is to establish a framework or model for general application.

Appendix A Calculation of Low Income Tax Credit

To calculate the actual credit received, the following formula is used:

$$\text{Credit} = (\text{Applicable \%}) (\text{Qualified Basis of Bldg.})$$

The applicable percent is set by the government at the following amounts:

Nine percent for new construction or substantial rehabilitation, with no federal funding.

Four percent for new construction or substantial rehabilitation financed with tax exempt financing, and below-market federal loans.*

Four percent for acquisition costs.

The nine percent rehabilitation credit and the four percent acquisition credit may both be claimed.

*The taxpayer has the option of excluding below-market federal loans from the qualifying basis to receive the nine percent credit. Rental subsidies under the HUD Section 8 program are not considered federal subsidies in this case.

Substantial rehabilitation is defined in this case to be capital expenditures of at least \$2,000 per low-income unit, over a 24 month period. Transfer of ownership is not required, meaning a taxpayer can rehabilitate a currently owned rental property.

The qualified basis is defined as the applicable fraction multiplied by the eligible basis. The applicable fraction is defined as the percent of a physical building housing low-income tenants. The credit is designed to insure that the average quality, area, and access to amenities for low-income units equals market rate units. The tax credit, however, may only be claimed on the low-income portion of the building.

The eligible basis is the actual dollar amount of hard or construction costs, excluding land acquisition costs. Building acquisition costs are eligible. The eligible basis may also include personal property that is reasonably required for the project, such as carpeting and appliances. Amenities may also be included providing that all tenants, low-income and market rate, have equal access to facilities. This includes pools, parking area, and recreational facilities.

A project with non-residential use cannot consider that portion of space in the basis calculation. Nor can federal grant money received throughout the 15 year compliance period be considered. These rules clearly promote equality of living space for both classes of renters. They also insure that funds are properly applied to residential space and not commercial space.

The credit is therefore defined as the product of the eligible basis and applicable fraction, multiplied by the applicable percentage. The following calculations will clarify the formula.

Situation:

- Substantial rehabilitation with no government funding. (9% credit applies)
- 50% low income units
- \$2 million project:
 - 200 total units of equal quality standard, @ \$5,000/unit = \$1,000,000.
 - Engineering fees, architectural fees and other soft costs, \$200,000.
 - Public amenities for all tenants, \$400,000.
 - Personal property, appliances, etc. \$200,000.
- Commercial Space, \$200,000. (Ineligible)

Formula:

$$\text{Credit Received} = (\text{Applicable \%}) (\text{Eligible basis} \times \text{Applicable fraction})$$

Solution:

$$\text{Credit Received} = (.09) (1,800,000 \times .5)$$

$$\text{Credit Received} = \$81,000 \text{ (received annually for 10 years)}$$

Source: Goldstein, Richard S. and Charles E. Edson. "The Tax Credit for Low-Income Housing," Real Estate Review, p. 49-60.

Appendix B

Income Targeting Thresholds

In mixed income projects, a certain number of units must remain as low-income in order to receive the credit. There are two income targeting standards that a landlord may apply.

The 20/50 rule requires at least 20 percent of the units must be rented to individuals whose income is 50 percent or less of the area median.

The 40/60 rule requires at least 40 percent of the units must be rented to individuals whose income is 60 percent or less of the area median.

(In New York City, a 25/60 rule applies because of unusually high rents).

Targeting figures are adjusted for family size. Project owners have 12 months to comply with targeting guidelines.

Rent restrictions insure that low-income rents are affordable, relative to other income levels. Gross rents and utilities, excluding telephone service, are restricted to no more than 30 percent of the income level for the unit. For example, in a neighborhood where the median income is \$20,000, the 40/60 rule would require 40 percent of the units to have maximum annual incomes of \$12,000, (60 percent of \$20,000). Annual rent is restricted to 30 percent, or \$3,600. Thus, monthly rent plus utilities would be set at \$300, adjusted for family size.

Other qualifications stipulate that all occupancy must be available to the general public. Tenants must be non-transient, with lease agreements of six months or longer. Credits are not available to shelters or temporary housing for the homeless. Hospitals, trailer parks, life care facilities, and similar living arrangements are also ineligible.

Source: Goldstein, Richard S. and Charles E. Edson. "The Tax Credit for Low-Income Housing," Real Estate Review, 49-60.

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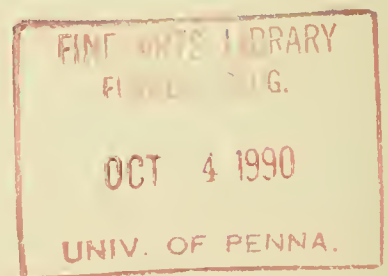
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